



## EMR Consultation Response Document (Part 4 of 7)

### Comments on CfD (Supplier Obligation) Regulations

<b>Name of reviewer</b>	ELEXON Ltd.
<b>Name of document being reviewed</b>	CfD (Supplier Obligation) Regulations

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				<p>The layout of this Regulation seems to make the obligations more complicated than they need to be, in particular the layout does not put related items together or in chronological order. To follow the logic of what is required at various times, the reader needs to follow many different cross references jumping between different parts of the Regulation. Compared with what the electricity industry is used to in traditional codes that cover settlement and payment issues, this makes it unfamiliar and somewhat opaque. We realise that this is a taxation Regulation, which is different from industry Codes, but we think the layout could lead to unnecessary disputes because the interpretation of requirements differs between parties who are bound by it.</p> <p>A clear and comprehensive explanatory text will be key to understanding these requirements if they retain the current form.</p>
				<p>The CfD (Supplier Obligation) Regulations are written in terms of payments due taking into account payments already actually made, for example, in regulation 9 dealing with reconciliation payments.</p> <p>The BSC, with which we are most familiar, is written in different terms and sets out what is due now implicitly assuming that previous payments due from that supplier have been made, because each invoice including the previous ones can be separately pursued for payment. For example, BSC Section N 6.4 on reconciliation is clear that reconciliation amounts due are based upon calculations of amounts due now less amounts previously calculated as due (note, not amounts actually received) for the same period. (Interest is also applied in the BSC, but this is not relevant to our point here.)</p> <p>BSC N 6.4.4 states: "It is hereby acknowledged and agreed that the obligations of Payment Parties and</p>



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				<p>the BSC Clearer under paragraphs 2.8.2 (a) and 6.4.2 are new obligations to pay an amount by way of Trading Charge and not an adjustment or amendment of any existing obligation and those obligations are subject to the provisions of paragraphs 2.4 to 2.7 (inclusive)."</p> <p>One way of reading the CfD (Supplier Obligation) Regulations could be that invoices are issued based on amounts now due and adding on any previous payments that are due for the same period but have not yet been received. So each invoice would replace or adjust a previous invoice, i.e. not the same as BSC N6.4.4. If so, this would seem more onerous as the Counterparty/settlement agent will have to keep tabs on all payments made to date and adjust new invoices in the light of this and presumably would have to extinguish the original invoice (?).</p> <p>To give a simple example, under the BSC, we could invoice an initial payment of £100 and then issue a reconciliation invoice for £2 making a total of £102 invoiced irrespective of whether the £100 had been paid. However, the Regulations might be read to require that the settlement agent in the same situation would invoice the supplier £2 at reconciliation if it has previously paid the £100; or invoice £102 if it has not and with the original £100 invoice then extinguished.</p> <p>However, we assume that the Regulations set out the total payment obligation of each supplier in respect of a given period, and do not require the invoices to follow the same process as long as the invoiced amounts so far issued in aggregate to a particular supplier in respect of a particular period are equal to the aggregate amounts calculated as due so far under the Regulations. In the above example, the settlement agent would invoice for £100 and then for £2 and the Regulations require £102 from that supplier so although there are two invoices, for £100 and £2 respectively, the total due is the same.</p> <p>Please advise if our assumption is wrong because this has major consequences for the settlement agent invoicing systems and the expectations we would need to convey to suppliers bound by these Regulations, many of whom would be familiar with BSC reconciliation invoices.</p>
			General Comment	<p>It is unclear whether the intention is that collateral can only be used to cover payments due but not paid under regulation 6 and other payments, e.g. those due under regulation 9 are not covered. Regulations</p>



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				3(5) and 14(11) only refer to regulation 6. If collateral cannot be used except for amounts overdue under regulation 6, this would lead to some consequences, such as the requirement to fund overdue regulation 9 payments from the reserve fund or mutualising – collateral and mutualised collateral could not be used. Note that the BSC works by calculating the required credit amounts based on initial settlement debts but it does <u>not</u> restrict the use of that credit to only initial settlement debts.
	General Comment			We believe that these Regulations may need deemed receipt provisions, e.g. for notices sent to suppliers.
	General Comment			There do not appear to be any provisions for the unlikely event that the settlement Body/agent does not receive the required information on supplier volumes from BSCCo (or other sources). The CfD contract has provisions for this eventuality, and the supplier regulations will also need this.
	General Comment			For the purposes of these regulations, it will be important to know when one working day finishes and the next begins.
	General Comment			"excluded electricity" is defined by reference to a separate Regulation. There needs to be a requirement in that Regulation or this for the provision of the volume of excluded electricity (however defined) to the CFD Counterparty including a statement of who is responsible for calculating and/or providing it.
Pg 3	Part 1 Introduction	Interpretation	2 (1)	<p>In these Regulations, the BSC is defined as a snapshot version as it was in force on 1 April 2014. However, the BSC is a living Code under its own governance which provides data to the CfD settlement process. A flexible approach to agreeing change in the BSC (and in future the Ireland Single Electricity Market (SEM) Code for Northern Ireland data) while not disturbing the CfD settlement process would be better than relying on a snapshot version of a Code that will change.</p> <p>We propose that where references are made to BSC data, this should include "its equivalent replacement, if amended".</p> <p>The alternative is that there will be requests to revisit the Regulations to accommodate changes in the BSC; or that the development of the BSC will be unnecessarily constrained because BSC modification</p>



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				<p>that would otherwise proceed will not be pursued because of this need to get Parliamentary approval for the Regulations.</p> <p>We also note that the definition of Balancing and Settlement Code in these Regulations is different from that in the draft CfD published on 12 August 2013, in which it is not a snapshot version.</p>
Pg 3	Part 1 Introduction	Interpretation	2 (1)	Reserve fund repayment is defined as: "is to be construed in accordance with regulation 14." But regulation 14 relates to 'collateral'. Should this refer to section 13 – 'Repayment of unused reserve payments'?
Pg 4	Part 2 Chapter 1	The supplier obligation	3(5)	See our general comment on collateral above. The reference to regulation 6 alone appears to mean that collateral can only be used for payments based on the BSC Interim Information Run? In fact 3(5) suggests that both collateral and mutualised collateral can only be used against these payments?
Pg 5	Part 2 Chapter 1	The supplier obligation	3(6)	The reference to Final Reconciliation Volume Allocation Run precludes the use of any subsequent Post-Final Volume Allocation Run data from the BSC (arising from any reconciliation to resolve disputes under the BSC). Is this what is intended?
Pgs 5 and 6	Part 2 Chapter 1	Determination of the supplier obligation	4(2)(b) and 5	<p>It is unclear why under 4(2)(b) there is a distinction made between suppliers who continue to hold their licence and a supplier who has ceased to hold a licence. The debts have accrued in respect of the period under which it was a licensed supplier and these amounts will be known in respect of all suppliers at the same time irrespective of when the supplier left the market. If we omit certain later data for a supplier who has left the market, e.g. from a BSC reconciliation run, then there could be an unpaid debt in respect of that supplier which would presumably need to be mutualised across the remaining suppliers?</p> <p>Regulation 5 makes reference to 4(2)(b) but because of the above, we are unsure that estimates are required.</p>
Pg 8	Part 2 Chapter 2	Interim payments –	7(7)	In defining baseload and intermittent CfD generators the regulations refer to baseload and intermittent generation technologies. These technologies should be defined.



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		levy rate calculations		
Pg 10	Part 2 Chapter 2	Reconciliation Levy Rate	10(1)	A supplier reconciliation levy rate will still not be final on 31 <sup>st</sup> March following the supplier obligation period as BSC reconciliations, for example, last for at least 14 months.
Pg 10	Part 2 Chapter 2	Reconciliation Levy Rate	10(5)	The reference to a reconciliation run in 10(5) may not work as by 30 <sup>th</sup> June (regulation 10(1)(a)), no reconciliation runs may yet have taken place according to the BSC definition of reconciliation runs for the last few days of March. 10(5) should refer to the latest volume allocation run. Or the concept of "relevant allocation run" as used in regulation 9 could be used throughout.
Pg 11-12	Part 2 Chapter 2	Interim Payments to suppliers	11	Regulation 11 is headed "Interim Payments to Suppliers". But this could be misleading given that it is an annual payment after 31 March each year whereas interim payments from suppliers are daily (at least during the period).
Pg 11-12	Part 2 Chapter 2	Interim Payments to suppliers	11	This deals with payments to suppliers arising from reconciliation runs. What if supplier has in the meantime ceased to hold a licence? What happens to the monies? This is related to the question of suppliers who owe money but have left the market, which we raised in a comment above.
Pg 11-12	Part 2 Chapter 2	Interim Payments to suppliers	11	The regulations are not clear on when this section applies, and when you allow for generator payments as part of the reserve fund reconciliation.
Pg 12	Part 2 Chapter 2	Interim Payments to suppliers	11(4)	This paragraph seems to be a comment with no requirement/obligation.
Pg12-13	Part 2 Chapter 3	Reserve fund payments	12(3) & (5)	An observation. The notice periods for reserve fund payments for the first obligation period and subsequent supplier obligation periods are less than the 3 months mentioned in Paragraph 254 of the Consultation document.
Pg 14	Part 2 Chapter 3	Reserve fund payments	12(11)	The references to reconciliation runs in 12(11) will not work for new suppliers' reference periods as reconciliation runs will not yet have taken place for the entire reference period (according to the BSC definition of reconciliation runs) by the time required for the notice according to 12(10)(c). 12(11) references should be to the latest volume allocation runs available for days in the reference period when



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				<p>the notice is prepared.</p> <p>Or the concept of "relevant allocation run" as used in regulation 9 could be used throughout.</p>
Pg 15	Part 2 Chapter 4	Collateral	14(3)	Read literally, this requirement will put all existing suppliers in breach for the first obligation period and does not fit with the timing of the publication of the Letter of Credit document terms as per regulation 14(5).
Pg 15	Part 2 Chapter 4	Collateral	14(4)(a)	<p>We suggest using an additional rating agency and then make the requirement that two out of three need to meet the minimum requirement, that way increasing the security to the market.</p> <p>We also suggest consideration is given to allowing one Letter of Credit to cover all the funds to which a supplier is required to contribute (although we do have strong reservations about the practicality of using of Letters of Credit for mutualised collateral – see our response to Question CFD35). If the supplier identifies what portion is allocated to each fund, this should enable Suppliers to keep the cost down of having to raise multiple Letters of Credit.</p> <p>For practical reasons because Letters of Credit have to be presented physically to the issuing bank for payment, Letters of Credit must be available for payment at a London branch of the issuing bank. (This also means that Letters of Credit from banks that don't have a London branch will not be accepted.)</p> <p>Also, to make a claim on a Letter of Credit it has to be signed in accordance with the approved bank mandate, so if the settlement agent is making a claim for payment to be made into another's bank account we need to explore with you what are the required practical arrangements to enable the encashment.</p>
Pg 16-17	Part 2 Chapter 4	Calculation of a supplier's collateral requirement	15(1) and (3)	<p>There is no provision for any case where a BSC settlement run has not been carried out for any of the 21 days required under 15(1).</p> <p>The reference to a reconciliation run in 15(3) is not correct as no reconciliation runs will have taken place according to the BSC definitions in the previous 26 days. 15(3) should refer to the latest volume</p>



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				allocation runs. Or the concept of "relevant allocation run" as used in regulation 9 could be used throughout.
Pg 17	Part 2 Chapter 4	Mutualised collateral	16(3)	Read literally, this requirement will put all existing suppliers in breach for the first obligation period and does not fit with the timing of the publication of the Letter of Credit document terms as per regulation 1(5).
Pg 17	Part 2 Chapter 4	Mutualised collateral	16(8)(a)	It is not necessary to require that the additional insolvency reserve is exactly equal to that which became inappropriate as long as the sum of that which became inappropriate plus that which is still appropriate (if any) is at least equal to the supplier's insolvency reserve requirement.
Pg 17	Part 2 Chapter 4	Mutualised collateral	16(9)(a)	It is not necessary to require that the additional insolvency reserve is exactly equal to the amount by which the insolvency reserve requirement increased as long as that which is now lodged in total (additional plus original) is at least equal to the supplier's insolvency reserve requirement. This is particularly the case when the supplier had over-provided collateral originally and the original amount is still sufficient for the new requirement.
Pg 18	Part 2 Chapter 4	Mutualised collateral	16(10)(a)	It is not necessary to require that the additional insolvency reserve is exactly equal to the amount that the CFD counterparty has used as that which remains is at least equal to the supplier's insolvency reserve requirement. This is particularly the case when the supplier had over-provided collateral originally and the reduced amount is still sufficient for the requirement.
Pg 19	Part 2 Chapter 4	Mutualised collateral	16(18)	The cross reference to paragraph (18) should be to paragraph (17).
Pg 20	Part 2 Chapter 4	Mutualised collateral	17(7)	<p>How are suppliers classified? If it is by supply licence, we note that this does not necessarily equate to the popular perception of large suppliers because supply companies may have multiple supply licences and currently only a few suppliers have over 10% of market share using this measure.</p> <p>A definition of a supplier is therefore necessary because the level (licensee or groups of licensees) at which suppliers are charged has implications for the insolvency reserve requirement calculations.</p>





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				In passing we also note that this regulation assumes that there will always be at least 9 SMSs.
Pg 20	Part 2 Chapter 4	Calculation of a supplier's insolvency reserve requirement	17(9)	The reference to reconciliation run will not work as reconciliation runs will not yet have taken place for the entire reference period (according to the BSC definition of reconciliation runs) by the time required for the determination under paragraph (2)/re-determination under paragraph (9). References should be to the latest volume allocation runs available for days in the reference period when the notice is prepared. Or the concept of "relevant allocation run" as used in regulation 9 could be used throughout.
Pg 21	Part 2 Chapter 4	Repayment of mutualised collateral	18(2)(a)	The formula is not required as it always simplifies to SU.
Pg 22	Part 2 Chapter 5	Enforcement of requirements	19(9)	The cross reference should be to regulation 26, rather than regulation 27.
Pg 23-24	Part 2 Chapter 5	Disputes – relevant notices & Disputes – relevant determinations	21(1) & 22(1)	Does this allow the CfD counterparty the option to determine that its original notice was correctly issued?
Pg 25	Part 2 Chapter 6	Discharge of obligations by payment	24(3)(c)	Are there specific timings required for the issuing of this notice?
Pg 25	Part 2 Chapter 6	Discharge of obligations by payment	24(4)(f)	Regulations 14(8) and 16(6) require that collateral is provided by 2pm on the 2 <sup>nd</sup> working day after the collateral has ceased to be sufficient/appropriate. Should this not be reflected in 24(4)(f), rather than requiring that the point in time specified?
Pg 26	Part 2 Chapter 6	Discharge of obligations by payment	24(6)	The order of priority could require that payments made to cover reconciliations are instead applied to cover a shortage of collateral. This in turn will require that collateral is drawn upon to make the reconciliation payments (subject to the general comment on the usage of collateral above).





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Pg 26	Part 2 Chapter 6	Discharge of obligations by payment	24(9)	This paragraph refers to paragraph (5). Should it be (6)?
Pg 26	Part 2 Chapter 6	Use of amounts and pro-rating	25(1), 25(2) and 25(3)	On the face of it these regulations prevent the usage of monies/collateral received from a supplier in a reconciliation run funding payments to other suppliers. This would be a very strange restriction. For example, it is entirely possible that a reconciliation run would not adjust any payments to CfD generators but would be truing up the relative amounts paid between suppliers whilst leaving the total payment to CfD generators unaltered. Under the BSC, reconciliation runs always end up changing the balance of monies between suppliers, so while some suppliers owe additional money, other suppliers are owed that money.
Pg 27	Part 3 Chapter 7	Interest rate	26(1)	This should also reference regulation 12(2) and the reference to regulation 28(4) should be to regulation 27(4).
Pg 27	Part 3 Chapter 7	Interest rate	26(1)	Why are the regulations restricted to the use of only June and December rates as rates can fluctuate?  Under BSC we take base rate on that day plus a percentage and this allows for current rates to be taken in to consideration. For example, if the rate goes up by 0.5% each month from June, meaning November is 2.5% higher we can take this into account under the BSC but not these Regulations.
Pg 28	Part 3 Chapter 7	The operational costs levy	27(4)	Should this read "where a supplier fails to make an operational levy payment <u>by...</u> ", rather than 'before'?
Pg 28	Part 3 Chapter 7	The operational costs levy	27(7)	The cross-reference should be to paragraph (6) rather than paragraph (7).  It is unclear why the operational levy rate is a fixed rate in perpetuity rather than a requirement based on the approved costs of the CfD counterparty for a given supplier obligation period.

