

## CAP 127 – 2<sup>nd</sup> Working Group

Wednesday 1<sup>st</sup> November 2006

<b>Present:</b>	Hedd Roberts (HR)	National Grid	Chair
	Beverley Viney (BV)	National Grid	Technical Secretary
<b>Members:</b>	Jenny Boothe (JB)	Ofgem	
	Paul Murphy (PM)	National Grid	
	Wayne Mullins (WM)	National Grid	
	Bec Thornton (BT)	National Grid	
	Andrew Colley (AC)	Scottish & Southern	
	Mark De Souza (MD)	npower	
	Lee Selway (LS)	EdF	
	Ben Sheehy (BS)	E.ON	
	Dave Wilkerson (DW)	Centrica	
	Carl Wilkes (CW)	npower	
<b>Apologies:</b>	Keith Munday (KM)	Bizz Energy	
	Dipen Gadhia (DG)	Ofgem	
	Paul Mott (PMo)	EdF	

### Introduction

HR outlined the timescales for this Working Group. The CUSC Panel has given the Working Group a 3 month timescale, therefore the Working Group Report needs to be issued to the Working Group members for comment no later than the 28 November in order to be issued with the CUSC Papers on 7 December.

The following future meeting dates were reiterated;

15<sup>th</sup> November

22<sup>nd</sup> November (provisional, as it is hoped the 15<sup>th</sup> will be the final meeting)

### Notes from 18<sup>th</sup> October

The notes emailed to the group by PM on 25 October 2006 were agreed by the Working Group Members.

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The following elements were looked at with a view to developing a “base VAR profile” for suppliers in general:

Weather Variability. The group agreed the most logical approach was to assume average weather conditions.

Triad Variability. Following the first working group meeting (18<sup>th</sup> October), further analysis of historical triad dates has been undertaken. As a result, it has become apparent that recent triad dates have occurred later than those observed in the 1990s. It was agreed that it was therefore sensible to use the average of triad dates since NETA go-live in determining the base VAR profile.

Further to this, AC suggested that 2<sup>nd</sup> January is likely to be a Bank Holiday, and should therefore not be considered as an average triad date, and that consideration should be given to avoid Bank Holiday dates.

**1. Action:** WM to consider taking unlikely triad dates (e.g. the Christmas period) out of the equation when calculating average triad dates.

Final Reconciliation. National Grid proposed the use of 0% and 2% of HH and NHH annual liability (respectively) to represent each applicable final reconciliation in the determination of the base VAR profile.

Some concern was raised due to there being an equal likelihood that the final reconciliation will be a credit or a debit to a supplier. However, there is still a realistic risk of an amount being due from a supplier. After discussing the issue, the majority of the group agreed that the best level to use for final reconciliation was 1% of NHH annual liability and 0% of HH annual liability.

Unpaid Invoices. Ofgem confirmed that the issuing of a Statutory Demand was a Commercial Decision for National Grid to make and that there were no rules that Ofgem applied to the timescales of issuing one.

National Grid agreed with Ofgem and stated that a pragmatic approach would need to be taken if a payment had been missed, and that it was not deemed appropriate to issue a Statutory Demand on the day after one missed payment.

National Grid suggested that a supplier would miss at least two payments in the majority of cases in which a supplier becomes insolvent, and that it is realistic to expect three to be missed prior to liabilities being taken on by an Administrator, Supplier of Last Resort or a Trade sale.

Concern was raised that the use of 2 or 3 missing payments in the determination of the base VAR profile may provide a barrier to enter the market (depending on the final methodology). However, it was also recognised that a realistic number of missed payments should be used, as the eventual solution should be reflective of the actual value at risk. It is important that the eventual solution strikes a balance between the risk of socialisation of unpaid liabilities and competition. National Grid proposed the use of two missed payments in the determination of the "base VAR profile", as this covered the amount which it deemed to be the minimum amount expected.

BS and AC agreed that in practice there would be a minimum of 2 months missed payments before a Statutory Demand was issued. LS gave the timescales for a statutory demand being issued against a shipper failing to pay gas balancing charges, which indicated at least two months worth of missed payments. JB/CW agreed that it can take up to 2 months for the Supplier of Last Report arrangements to be implemented.

The majority of the working group agreed that two missed payments was an appropriate level to use. One member requested that National Grid provide a timeline of actions that would be followed following a payment being missed, all the way up to the issuing of a statutory demand. It was also noted that a similar process had recently been added to the DCUSA and it may be worth considering whether this would provide an appropriate indication to the number of missed payments expected.

The following **actions** were agreed:

2. PM to produce timeline from 1<sup>st</sup> missed payment to issuing of statutory demand
3. PM to check if there are any 'minimum value outstanding' criteria that must be met in order to issue a statutory demand
4. PM to check how DCUSA treats missed payments and statutory demands, bearing in mind any differences in base assumptions

#### Base VAR and Security Periods

National Grid proposed that the year was divided up into multiple security periods and that in each security period, the base VAR profiles were used to determine a base level of security (as a proportion of their current forecasted liability) for every supplier to provide in relation to their HH and NHH liabilities.

National Grid proposed that 2 security periods (commencing 15<sup>th</sup> August and 13<sup>th</sup> December) were used based upon when a significant level of risk was apparent when the realistic maximum VAR profile (including 20% under forecast and early triad dates) was considered. Some alternative sets of periods were suggested by members of the working group:

- monthly security periods;
- quarterly periods; and
- two security periods, similar to National Grid's proposal, but with the second period commencing on 1<sup>st</sup> November.

Further to this, National Grid proposed that the base security requirement in each security period was calculated as the average amount at risk of socialisation indicated by the base VAR profile. This essentially collars the VAR for any period in which a supplier is in credit at zero, as this amount would be returned to the supplier in the event of them becoming insolvent and exiting the market (assuming no other amounts were due to National Grid). One working group member raised a concern over whether or not this was appropriate since it could lead to over securitisation when a supplier is effectively in credit. National Grid pointed out that the maximum VAR profile indicated that a risk of a supplier being in debit was present during the specific periods in question (13<sup>th</sup> December to 2<sup>nd</sup> January), and as a result an amount of security should be held to cover this risk.

At this stage a detailed discussion was held by the group regarding the potential interaction with BSUoS charges, and whether an alternative amendment would look at TNUoS and BSUoS in unison.

**5. Action:** PM to look at BSUoS netting off and interaction between TNUoS and BSUoS VAR.

The following alternative methods for the determination of the base level of VAR in each security period were suggested:

- The maximum value indicated by the base VAR profile in the relevant security period; and
- An absolute average of the base VAR profile in the relevant security period (i.e. not capping credits to zero);

LS stated that the absolute average of the base VAR profile in the relevant security period should always be covered and that the current proposal was too smooth and therefore a greater number of security periods were required.

**6. Action:** WM to analyse the impact of implementing possible combinations of the proposed and alternative security periods and methods to determine the base level of VAR.

### Forecasting Performance

National Grid reiterated the fact that a supplier's forecasting performance has a significant impact on the level of actual VAR. As this is something within a supplier's control, National Grid believes that it is worthwhile for any final solution to provide supplier's with an incentive to forecast accurately during those periods in which the effect of under forecasting is greatest. It was agreed that the current calculation of VAR was open to gaming since it is based on only 1 month's level of under forecasting.

A methodology of taking an average of forecasting performance over the last six months of a previous year, using the actual annual liability (from the last calculated initial reconciliation) was presented by National Grid as an initial proposal. Concern was raised that this methodology could discriminate against a supplier if they unexpectedly picked up extra customers (e.g. following another supplier becoming insolvent).

National Grid reiterated the need to take a balanced approach of risk when setting a forecast performance value and that its analysis is based on a typical Supplier profile, taking into account the usual patterns of taking on additional customers, thus the forecasting of these additional customers was in the control of the Supplier.

In addition, it was argued that any average should be taken over the last five months as the forecast made for November's TNUoS bill is required by 10<sup>th</sup> October, which is the first submission following/during the October tender round.

Another member of the group suggested the use of a "weighted" average along similar lines. However, no suggestions were made as to what level of weighting should be applied to each month.

Other suggested methodologies included:

- using a rolling 12 month average; and
- using a six month average, but with an appeals process (where a significant amount of additional customers are taken on outside the Users ability to forecast fro the accurately); and
- comparing HH forecasts to an amount indicated by demands taken by a supplier's customers over each triad peak. (The effect of triad predictability was raised as an issue here. i.e. if most demand was taken over one peak this may indicate an under forecast).

The potential of pre-payment was also raised as something to be considered. PM noted that a similar discussion was made in working groups relating to CAP099 and that there was an agreement that pre-payment should not be considered. The deadline for the last supplier forecast used for monthly billing is 10<sup>th</sup> February. A supplier can therefore control their payments up to this date via their forecasts, any additional payments would therefore not be expected until after this date, by which time much of the impact of under forecasting on VAR has most likely to have already taken effect (as indicated in the presentations given to date).

The following **actions** were agreed to be discussed further at the next meeting:

7. All group members to consider solution options raised and any other possible solutions prior to the next meeting;
8. The group to discuss prioritise and assess all proposals based on their ability to rectify the defect and against the CUSC Applicable Objectives, at the next meeting.

### **Next Meeting**

10am, 15<sup>th</sup> November at National Grid House, Warwick.

NB – KM asked if the meeting could be moved from 15<sup>th</sup> November. After consideration, BV identified an available room on 13<sup>th</sup> November. Unfortunately, other working group members were unavailable on 13<sup>th</sup> November and therefore the meeting will go ahead on 15<sup>th</sup> November as scheduled.