

The impact of BETTA upon the Settlement Agreement for Scotland (SAS)

An Ofgem/DTI consultation

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Summary

In a December 2001 consultation paper¹, Ofgem/DTI set out their vision of a model that would enable all consumers in Great Britain (GB) to benefit from competitive wholesale markets. The set of proposed reforms outlined in that paper is termed the British Electricity Trading and Transmission Arrangements (BETTA).

In May 2002², Ofgem/DTI set out their preliminary views in light of responses to the December 2001 consultation. Ofgem/DTI stated their view that one of the key components of BETTA was the introduction of a single code covering trading, balancing and settlement arrangements across GB, using arrangements applying in England and Wales as a basis for consultation.

Ofgem/DTI have recently issued a consultation paper on the development of a Balancing and Settlement Code (BSC) to apply across GB³. The introduction of trading, balancing and settlement across GB will render the current trading arrangements in Scotland redundant. One of the key processes that supports those trading arrangements is the calculation and allocation of metered volumes to parties trading in Scotland. This process takes a period of 14 months after the trading day in question to complete. The Settlement Agreement for Scotland (SAS) is the document that sets out the rules and mechanisms for this settlement process. The introduction of a GB BSC would mean that the allocation of energy under the SAS would not be needed for trading days that occur after BETTA has been implemented.

However, in order to facilitate the full reconciliation of energy traded on days prior to the implementation of BETTA, and to allow an appropriate period of time for the resolution of any disputes in relation to such trading days, the SAS will need to remain in force for a period following the implementation of the new GB settlement arrangements. This period is referred to as the SAS run-off period.

The aim of this consultation paper is to set out the issues that need to be resolved in order to provide for the efficient administration of the SAS arrangements during a run-off period and invite views on the appropriate resolution of such issues.

This paper:

¹ 'The Development of British Electricity Trading and Transmission Arrangements (BETTA): A consultation paper', Ofgem, December 2001 Ofgem 74/01.

² 'The Development of British Electricity Trading and Transmission Arrangements (BETTA): Report on consultation and next steps' Ofgem/DTI, May 2002 Ofgem 38/02.

- ◆ provides background on the operation of the existing settlement arrangements in Scotland
- ◆ considers the impact that the introduction of a GB BSC may have on the existing settlement arrangements in Scotland, and
- ◆ highlights issues for consideration and invites views.

Ofgem/DTI anticipate that a report will be published in March 2003, which will set out Ofgem/DTI's conclusions on the impact of BETTA on the SAS, in view of responses to issues raised in this paper.

³ 'The Balancing and Settlement Code under BETTA: An Ofgem/DTI consultation on a BSC to apply throughout GB', Ofgem/DTI, December 2002.

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1. Rationale

- 1.1. The rationale for the British Electricity Trading and Transmission Arrangements (BETTA) reforms is set out in a consultation paper of December 2001⁴ ('the December 2001 consultation') and a report of May 2002⁵ ('the May 2002 report'). Furthermore, the DTI has published a draft Regulatory Impact Assessment (RIA), which explains the purpose and impact of the proposed primary legislation to enable the BETTA reforms. The final RIA, to be published with the Electricity (Trading and Transmission) Bill, will set out the expected costs and benefits of BETTA. BETTA go-live is planned for April 2004⁶.
- 1.2. The December 2001 consultation proposed that GB wide trading arrangements should be achieved by introducing a Balancing and Settlement Code (BSC) to apply across the whole of GB (the GB BSC), using arrangements applying in England and Wales as a basis for consultation.
- 1.3. The May 2002 report noted that the majority of respondents to the December 2001 consultation supported the introduction of a GB BSC and the use of the England and Wales settlement systems to support a GB BSC. Ofgem/DTI believe that one of the key components of BETTA is the introduction of a single code covering trading, balancing and settlement arrangements across GB, using arrangements applying in England and Wales as a basis for consultation. The introduction of a GB BSC is the subject of a separate Ofgem/DTI consultation, published in December 2002⁷.
- 1.4. The introduction of trading, balancing and settlement across GB will render the current trading arrangements in Scotland redundant. One of the key processes that supports those trading arrangements is the calculation and allocation of metered volumes to parties trading in Scotland. The Settlement Agreement for Scotland (SAS) is the document that sets out the rules and mechanisms for this settlement process. The SAS is publicly available and is contractually binding

⁴ 'The Development of British Electricity Trading and Transmission Arrangements (BETTA): A consultation paper', Ofgem, December 2001 Ofgem 74/01.

⁵ 'The Development of British Electricity Trading and Transmission Arrangements (BETTA): Report on consultation and next steps' Ofgem/DTI, May 2002 Ofgem 38/02.

⁶ This is subject to the Electricity (Trading and Transmission) Bill being introduced in the current Parliamentary session and Royal Assent to the E(TT) Bill by September 2003.

⁷ 'The Balancing and Settlement Code under BETTA: An Ofgem/DTI consultation on a BSC to apply throughout GB', Ofgem/DTI, December 2002.

amongst the various parties to it. The purpose of this paper is to consider the impact that the introduction of a GB BSC will have on the existing settlement arrangements in Scotland and seek views on this.

- 1.5. Other than the SAS, the contracts that underpin trading in Scotland are bilateral trading agreements. Parties trading under the SAS enter into bilateral trading agreements, which are private contracts between the parties concerned. This is explained in more detail in chapter four. Ofgem/DTI expect that parties to these agreements will take appropriate steps to manage their contracts in view of the anticipated implementation of BETTA.

Requirement for SAS run-off period

- 1.6. The reconciliation and allocation process under the SAS takes a period of 14 months to complete, after the trading day in question. The SAS is examined in greater detail in chapter four. The introduction of a new set of energy balancing and settlement arrangements to apply across GB in the form of a GB BSC, would supersede the SAS on trading days following BETTA go-live.
- 1.7. However, in order to facilitate the full reconciliation of energy traded on days prior to BETTA go-live, and to allow an appropriate period of time for the resolution of potential disputes, the SAS will need to remain in force for a period following the implementation of the new GB settlement arrangements. This period is referred to in this document as the SAS run-off period.

Issues to be considered

- 1.8. Chapter five of this paper highlights, and invites views on, a number of issues that need to be addressed in order to provide for SAS run-off and the eventual replacement of the existing settlement arrangements in Scotland with those contained within the GB BSC. These are:

Administration of run-off

- 1.9. Scottish Electricity Settlements Limited (SESL) is currently responsible for carrying out the role and functions of Scottish Settlements as defined in the SAS. During the run-off period, it may be appropriate to consider whether this role should remain with SESL, or become the responsibility of the body appointed to

administer the GB BSC (the GB Balancing and Settlement Code Company (GB BSCCo)). Views are invited on who should be responsible for administering Scottish Settlements during the SAS run-off period.

Extent of reconciliation under SAS run-off

- 1.10. This paper considers the possibility of curtailing energy reconciliation for the SAS run-off period from 14 to eight months. The energy reconciliation process under the SAS is explained in more detail in chapter four. The purpose of curtailing reconciliation would be to reduce the period of time that the existing Scottish settlement systems would need to be maintained, and potentially save costs to the market.
- 1.11. Ofgem/DTI recognise that such a potential benefit must be set against the possibility of deterioration in the quality of data relating to settlement days reconciled under SAS run-off. Views are invited on the proposal to curtail reconciliation.

Disputes

- 1.12. The existing SAS disputes process sets no time limit on raising a dispute following the final reconciliation run of the settlement systems. If no time limit is in place, a body capable of administering SAS disputes will be required to be in place indefinitely following the implementation of BETTA. To avoid the costs associated with such a requirement, it might be considered desirable to limit the run-off period, which in turn would require that the existing disputes provisions should be time limited. Ofgem/DTI are of the view that the existing disputes provisions within the SAS should be modified. It should be noted that this approach is dependent upon a suitable modification to the SAS being proposed and subsequently approved by the Authority. Views are invited on the introduction of a time limit for the raising of disputes.
- 1.13. Ofgem/DTI recognise that it is possible that SAS parties may not consider it appropriate to introduce a time limit for raising disputes under the SAS. Were this to be the case, the SAS would continue in existence for the purposes of dispute resolution. However other issues in this document have been considered with the underlying assumption that a cut-off period for raising disputes will be introduced and that the SAS will therefore have an identifiable

run-off period determined by the amount of time to complete reconciliation and allocation processes plus an amount of time for raising any disputes.

Cost recovery

- 1.14. It will be necessary to enable the body responsible for administering Scottish Settlements during the run-off period to recover its operating costs. Operating costs are currently recovered as a portion of the settlement charges applied to SAS parties. Settlement charges are recovered monthly on the basis of actual energy generated or supplied. The termination of SAS processing in respect of days after BETTA go-live would remove the current mechanism for cost recovery under the SAS, as the data required to levy settlement charges would no longer be available. Views are invited on establishing an alternative means of recovering these costs for the run-off period.
- 1.15. In addition to recovering operating costs, it will also be necessary to establish a mechanism to facilitate recovery of outstanding 1998 Project costs⁸, as these costs are also currently recovered as a portion of the settlement charges. Ofgem/DTI recommend that an appropriate mechanism is established to enable these costs to be recovered from parties trading in Scotland prior to BETTA go-live, that enables allocation of these costs on the basis of historical trading data. Views are invited on this proposal and on an appropriate trading period to use as the basis for this allocation.

Options for SAS post run-off

- 1.16. Following the expiry of the run-off period, reconciliation of energy under the SAS and the ability to raise disputes will cease. It may be appropriate for the SAS run-off arrangements explicitly to provide for the termination of the SAS at the end of run-off. Alternatively, it may be appropriate for the run-off arrangements to make provision for certain functions of the SAS to cease to operate post run-off, although the agreement itself would not necessarily be terminated. At the end of run-off, all SAS parties could choose to resign from the agreement, or indeed choose to terminate the SAS themselves, as provided for in

⁸ Cost incurred by Scottish Power UK plc and Scottish and Southern Energy plc, as a result of the 1998 Scottish settlements project which was established in order to facilitate the introduction of full retail competition in Scotland in 1998/99.

clause 128 of the agreement⁹. Views are invited as to the most appropriate route following the expiry of the SAS run-off period.

Licence implications

- 1.17. Special condition H and special condition I in the distribution licence of both Scottish Hydro Electric Power Distribution Limited (SHEPDL) and SP Distribution Limited (SPDL) require these licensees jointly to establish supply arrangements for Scotland and establish the SAS to facilitate the functioning of these arrangements. Ofgem/DTI propose that these conditions are amended to provide for SAS run-off arrangements. Following the expiry of SAS run-off, Ofgem/DTI consider that these conditions are obsolete and can therefore be removed from the licences of SPDL and SHEPDL.
- 1.18. In addition, it is a standard condition of the electricity generation and supply licences to become a party to the SAS and to comply with the SAS, and a standard condition of the electricity transmission and distribution licences to comply with the SAS. Ofgem/DTI propose that these conditions are amended to take account of SAS run-off. Following the expiry of SAS run-off, Ofgem/DTI consider that these conditions are obsolete and can therefore be removed from the standard electricity generation, supply, distribution and transmission licences.

Way Forward

- 1.19. Chapter six sets out Ofgem/DTI's preliminary views on how SAS run-off arrangements may be effected. It is likely that in order to facilitate SAS run-off, a number of SAS modifications will be required. Ofgem/DTI anticipate such modifications will be taken forward following the modification procedure established in the SAS. Any modification proposed will be viewed on its own merits and approved or rejected in accordance with the consideration of the modification proposal and the Authority's statutory duties. Ofgem/DTI also anticipate that any licence amendments that will be required to provide for SAS

⁹ Part IX, Clause 128.2 of the SAS states "This Agreement may be terminated by agreement in writing of all the parties with consent in writing of the Director to take effect from the later of the date agreed between the parties and the date of the said consent of the Director". (Schedule 1 of the SAS defines 'Director' as 'the Gas and Electricity Markets Authority established by Section 1 (1) of the Utilities Act 2000' (the 'Authority')).

run-off will be progressed in parallel with the other licence amendments that are likely to be required for the implementation of BETTA¹⁰.

¹⁰ Ofgem/DTI will publish shortly a consultation on the changes required to the standard electricity generation, distribution and supply licences under BETTA, and separately a consultation on the changes required to the standard electricity transmission licence under BETTA.

2. Timetable

- 2.1. Ofgem/DTI anticipate that a report will be published in March 2003, which will set out Ofgem/DTI's conclusions on the impact of BETTA on the SAS, in view of responses to issues raised in this paper.
- 2.2. Chapter six of this paper sets out Ofgem/DTI's views on the way forward following publication of its conclusions paper.

Views invited

- 2.3. Parties are free to raise comments on any of the matters covered in this paper and in particular on the items requested. All responses, except those marked confidential, will be published on the Ofgem website and held electronically in Ofgem's Research and Information Centre. Respondents should try to confine any confidential material in their responses to appendices. Ofgem prefers to receive responses in an electronic form so that they can easily be placed on the Ofgem website.
- 2.4. Responses, marked 'Response to SAS consultation' should be sent by 7 February 2003 to:

Patrick Smart
BETTA Project
Office of Gas and Electricity Markets (Ofgem)
9 Millbank
London
SW1P 3GE
Fax: 020 7901 7479

Please email responses to BETTA.consultationresponse@ofgem.gov.uk marked 'Response to SAS consultation'.

All consultation responses will be forwarded to the DTI.

- 2.5. If you wish to discuss any aspect of this document, please contact Lesley Nugent (email lesley.nugent@ofgem.gov.uk, telephone 0141 331 2012) or Nicola

Douce at the DTI (email nicola.douce@dti.gsi.gov.uk , telephone 020 7215 2779).

3. Background

- 3.1. In the December 2001 consultation Ofgem/DTI set out their vision of a model that would enable all consumers in Great Britain to benefit from competitive wholesale markets. The set of proposed reforms outlined in that paper is termed the British Electricity Trading and Transmission Arrangements (BETTA).
- 3.2. It is proposed that under BETTA there will be a single code covering trading, balancing and settlement arrangements across GB, using arrangements applying in England and Wales as a basis for consultation. The introduction of a GB BSC is the subject of a separate Ofgem/DTI consultation, published in December 2002¹¹.
- 3.3. The rules and mechanisms which currently support the settlement and reconciliation of energy supplied in Scotland are defined within the Settlement Agreement for Scotland (SAS). This agreement is examined in greater detail in chapter four of this document. The introduction of a new set of energy balancing and settlement arrangements GB-wide in the form of a GB BSC, would mean that the allocation of energy under the SAS would not be needed for trading days that occur after BETTA go-live, as such energy allocation processes would occur under the GB BSC.
- 3.4. The purpose of this document is to consider the key issues arising in relation to the SAS as a result of the introduction of BETTA, to set out Ofgem/DTI's provisional thinking on such matters, and to invite views from interested parties.
- 3.5. This document will:
 - ◆ provide background on the operation of the existing settlement arrangements in Scotland
 - ◆ consider the impact that the introduction of a GB BSC may have on the existing settlement arrangements in Scotland, and
 - ◆ highlight issues for consideration and invite views.

¹¹ 'The Balancing and Settlement Code under BETTA: An Ofgem/DTI consultation on a BSC to apply throughout GB', Ofgem/DTI, December 2002.
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4. The SAS and Scottish Settlements

The Settlement Agreement for Scotland

- 4.1. Scottish and Southern Energy Plc (SSE) and Scottish Power Plc (SP) were jointly required by licence conditions 23 and 24 of their Public Electricity Supply (PES) licences to establish supply arrangements for Scotland and to establish the Settlement Agreement for Scotland (SAS) to facilitate the functioning of these arrangements. These licence conditions remain in force as special condition H and special condition I in the distribution licences of Scottish Hydro Electric Power Distribution Limited (SHEPDL)¹² and SP Distribution Limited (SPDL).¹³
- 4.2. Under the current wholesale electricity trading arrangements in Scotland, electricity is traded via bilateral agreements. To enable parties to settle these agreements, the SAS contains procedures for the calculation and allocation of volumes of energy to suppliers and generators trading in Scotland and makes provision for matters ancillary to these processes to facilitate competition in electricity supply in Scotland. Licensed suppliers and generators trading within Scotland are obliged to become a party to and comply with the provisions of the SAS, while transmission and distribution licensees operating in Scotland are obliged to comply with the SAS.¹⁴

Scottish Electricity Settlements Limited (SESL)

- 4.3. The SAS requires that energy settlement functions are undertaken, or procured by an entity fulfilling the role of Scottish Settlements. Scottish Electricity Settlements Limited (SESL), a company jointly owned by SP and SSE, is appointed under the SAS to fulfil the Scottish Settlements obligations. All SESL staff are permanently seconded from either SP or SSE. In practice, SESL operates as a non profit making organisation and has no source of revenue other than

¹² On 1 October 2001, Scottish and Southern Energy plc demerged into four separate legal entities, by virtue of the effect of the licensing and transfer schemes made by the Secretary of State under Schedule 7 of the Utilities Act 2000.

¹³ On 1 October 2001, ScottishPower UK plc demerged into four separate legal entities, by virtue of the effect of the licensing and transfer schemes made by the Secretary of State under Schedule 7 of the Utilities Act 2000.

¹⁴ Standard Supply Licence Condition 8; Standard Generation Licence Condition C4; Standard Transmission Licence Condition D6; Standard Distribution Licence Condition 12.

through performing the role of Scottish Settlements. Its objectives under the SAS in carrying out the role of Scottish Settlements are limited to those set out in Part II of the SAS. These reflect the licence obligation on SPDL and SHEPDL and provide for fulfilling the following objects:

- ◆ to enable electricity suppliers, other than Scottish Power Energy Retail Limited and SSE Energy Supply Limited, to have their volumetric purchases of electricity from portfolio generators and from parties to the BSC correctly allocated to them
- ◆ to enable electricity suppliers, other than Scottish Power Energy Retail Limited and SSE Energy Supply Limited, and portfolio generators, other than Scottish Power Generation Limited and SSE Generation Limited, to have their volumetric residual electricity requirements and provisions correctly allocated to them
- ◆ to enable electricity suppliers to have their volumetric supplies of electricity to customers correctly allocated to them
- ◆ to facilitate the calculation of accurate information regarding the aggregate amount of electricity provided to Scottish Power Energy Retail Limited by Scottish Power Generation Limited in its capacity as a portfolio generator and to SSE Energy Supply Limited by SSE Generation Limited in its capacity as a portfolio generator, and
- ◆ to provide for such matters ancillary to those specified above as are or may be appropriate to facilitate competition in electricity supply in Scotland.

4.4. In practice SESL is therefore constrained in the activities that it can undertake, as funding is only made available in relation to activities required to satisfy the obligations of Scottish Settlements as defined by the SAS. Any modifications to the SAS cannot be outside of the objectives of the SAS, and the SAS objectives must reflect the licence obligation on SHEPDL and SPDL, set out above.

Central Allocation System (CAS)

- 4.5. SESL is responsible for ensuring the operation of the settlement systems in Scotland, which are collectively referred to as the Central Allocation System (CAS). CAS is made up of two separate systems, Initial Allocation and Reconciliation (IAR), which processes energy volumes to be attributed to suppliers, and Generation Allocation (GA).
- 4.6. There are two separate settlement areas in Scotland, and energy values relating to trades in these two areas are calculated independently of each other. One settlement area comprises the north of Scotland, and reflects the distribution services area of SHEPDL, as defined in SHEPDL's distribution licence.¹⁵ The other settlement area is the south of Scotland and reflects the distribution services area of SPDL, as defined in SPDL's distribution licence¹⁶.
- 4.7. For each settlement day, there are five settlement runs of each CAS system in each settlement area over a 14 month period, during which time SAS parties provide CAS with data relating to flows of energy delivered to and taken from the system on that day. From run to run, the accuracy of data entering the settlements systems should improve, until the targets set out in the SAS¹⁷ for minimum levels of actual metered (as opposed to estimated) data held within CAS are met at the final reconciliation run (RF).

Energy allocation and reconciliation processes

- 4.8. The rules governing energy allocation and reconciliation in Scotland closely reflect those defined within the BSC for England and Wales and consequently the operational procedures are also very similar.
- 4.9. The main features are:
- ◆ suppliers and generators are obliged to appoint accredited agents to form supplier hubs¹⁸ for both the half hourly (HH) and the non-half hourly (NHH) market

¹⁵ Schedule 3 of the distribution licence of SHEPDL.

¹⁶ Schedule 3 of the distribution licence of SDPL.

¹⁷ Schedule 8 of the SAS.

¹⁸ "Supplier Hub" means a Supplier and a particular group of its Agents comprising a Data Collector, Data Aggregator and Meter Operator. (Schedule 2 of the SAS)

- ◆ Meter Operators and Data Collectors are obliged to hold and maintain certain items of standing data (meter technical details, meter read histories) and transfer such data to other market participants in certain circumstances
- ◆ a Data Collector must collect and process actual meter read data within defined timescales
- ◆ Data Aggregators provide aggregated data to CAS
- ◆ supplier initial allocations are based on forward looking estimate (Estimated Annual Consumption (EAC¹⁹)) values which are then reconciled to actual consumption (Annualised Advance (AA)) values when meters are read, and
- ◆ energy settlement is run by a central agent (Initial Allocation and Reconciliation Agent (IARA)) with initial allocation taking place 17 working days after the settlement day and then reconciliation runs after 6 weeks, 4 months, 8 months and then final reconciliation after 14 months.

Contract forms under the SAS

4.10. To fulfil SAS entry process requirements, generators who are party to the SAS must enter into a residual contract with the Host Company's²⁰ Generation Undertaking²¹, for each settlement area.²² Suppliers who are party to the SAS are also required to enter into a residual contract or alternatively a 100 per cent of

¹⁹ Estimated Annual Consumptions are energy values based on estimates derived from meter read history and industry standard load profiles.

²⁰ The term 'Host Company' is defined in Schedule 1 of the SAS as follows:

"means the ScottishPower Generation Undertaking, the ScottishPower Transmission Undertaking, the ScottishPower Distribution Undertaking, and/or the ScottishPower Supply Undertaking, and/or the Scottish and Southern Energy Generation Undertaking, the Scottish and Southern Energy Transmission Undertaking, the Scottish and Southern Energy Distribution Undertaking, and/or the Scottish and Southern Energy Supply Undertaking, where appropriate as owner of the relevant Transmission System or Distribution System or in its capacity as supplier within its supply services are (in Scotland) (as defined in the relevant Supply Licence)".

²¹ In the north of Scotland, SSE Generation Ltd; in the south of Scotland, SP Generation Ltd.

²² SAS Schedule 14, Chapter 4, MP-204, section 1.3.4.4.

demand contract with the Host Company's Generation Undertaking, for each settlement area.²³

4.11. In addition, the SAS requires suppliers and generators to use reasonable endeavours to minimise their requirements for top-up and spill. They attempt to meet this obligation by entering into one of four types of bilateral purchase contracts available under the SAS:

- ◆ per cent of output
- ◆ firm MW
- ◆ per cent of demand, or
- ◆ tranche of output.

4.12. These are the only contract forms available to parties trading under the SAS. The contracts discussed in 4.9 and 4.10 above are private bilateral agreements. Ofgem/DTI expect that parties to these agreements will take appropriate steps to manage their contracts in view of the anticipated implementation of BETTA.

Governance of the SAS

4.13. The governance provisions are contained within Part IX of the SAS. This establishes four panels:

- ◆ Modifications Panel
- ◆ Performance Assurance and Accreditation Panel (PAAP)
- ◆ Disputes Panel, and
- ◆ Finance and Audit Panel (FAP).

4.14. SESL provides the secretariat function and administrative support for these four panels.

²³ SAS Schedule 15, Chapter 7, MP-512, clause 1.3.5.4.

- 4.15. Each panel is made up of representatives of the 'Scottish Companies' as well as 'Non-Scottish Company' representatives. The term 'Scottish Company' is used in the SAS to refer to SP or SSE (or both of them), as appropriate²⁴.
- 4.16. The Modifications Panel comprises four Scottish Company members and four Non-Scottish Company members. It considers and votes upon proposed modifications to the SAS and, in certain circumstances²⁵, proposed changes to the Master Registration Agreement (MRA). Modifications to the SAS cannot be made without the prior consent of the Authority.
- 4.17. The remaining panels comprise three Scottish Company members and three Non-Scottish Company members. The PAAP monitors performance of suppliers and their appointed agents and deals with any performance issues and failures. It also decides upon the accreditation and certification of supplier agents and assesses the performance of suppliers and generators that have applied to be parties to the SAS against the SAS entry process requirements.
- 4.18. The FAP appoints the Market Auditor and reviews the annual audit plan as well as the annual audit report itself. It also reviews SESL operating budgets and settlement charges, before these are submitted to the Authority for approval.
- 4.19. The Disputes Panel investigates and attempts to resolve disputes arising from trading queries (eg energy allocation data) or matters referred directly under the SAS.

Cost recovery and charging

- 4.20. The amount of costs that SESL can recover in any year is referred to in the SAS as the 'Total Cost Recovery'²⁶. The Total Cost Recovery comprises two elements:
- ◆ SESL's forecast operating costs for the coming year, and
 - ◆ a specified portion of the costs incurred by SP and SSE as a result of the 1998 Scottish settlements project, which established the SAS and SESL.

²⁴ Schedule 1 of the SAS contains the following definition of the term 'Scottish Company': "means Scottish Hydro-Electric or ScottishPower, as appropriate and Scottish Companies means both of them".

²⁵ The MRA change process makes provision for participation by a SESL representative. The extent of SESL's rights and obligations are defined in clause 9 of the MRA.

- 4.21. SP and SSE jointly incurred £39 million in set up costs arising from the 1998 Scottish settlements project. These costs are referred to within the SAS as the recoverable development costs and were to be recovered over a period of seven years. As at April 2004²⁷, £10.3 million of these costs will remain outstanding to SP and SSE.
- 4.22. SESL's Total Cost Recovery for any year is established by the FAP and is recovered via settlement charges applied to all SAS parties trading in Scotland. Costs are recovered from both suppliers and generators, split 30 per cent from generator parties and 70 per cent from supplier parties. Generators and suppliers, in respect of their customers with NHH metering, pay a fixed rate per unit (kWh) of allocated energy. For 2002/2003, the generator charge is 0.00837736p per kWh, and the NHH supplier charge is 0.02509479p per kWh. Suppliers also pay a fixed rate of £200 per registered meter per annum in respect of each HH customer registered to them.

²⁶ Part VIII of the SAS, clause 62.

²⁷ BETTA go-live is planned for April 2004. This is subject to the Electricity (Trading and Transmission) Bill being introduced in the current Parliamentary session and Royal Assent to the E(TT) Bill by September 2003. The impact of BETTA on the SAS

5. Issues for consideration

- 5.1. Licensed suppliers and generators operating in Scotland are required by their licence to become a party to the SAS and comply with the provisions of the SAS. It is proposed that under BETTA there will be a single BSC to apply throughout England and Wales and in Scotland, and parties trading in GB will be required by licence to comply with the provisions of such an agreement. The introduction of a new set of energy balancing and settlement arrangements in the form of a GB BSC would mean that the allocation of energy under the SAS would not be needed in respect of trading days that occur after BETTA go-live.
- 5.2. In order to facilitate the full reconciliation of energy in relation to trading days that occurred prior to BETTA go-live, and to allow an appropriate period of time for the resolution of disputes, the SAS will need to remain in force for a period following the implementation of the new GB settlement arrangements. This period is referred to in this document as the SAS run-off period. This chapter highlights issues that may need to be addressed in order to facilitate SAS run-off under BETTA, and provide for the replacement of the existing settlement arrangements in Scotland with those contained within the GB BSC.
- 5.3. The following issues are considered in this chapter:
- ◆ vehicle for SAS run-off
 - ◆ administration of run-off
 - ◆ extent of reconciliation under SAS run-off
 - ◆ disputes under SAS run-off
 - ◆ cost recovery
 - ◆ options for SAS post run-off, and
 - ◆ licence implications

Vehicle for SAS run-off (SAS or supplement to GB BSC)

- 5.4. It may be appropriate to incorporate the SAS provisions necessary to support SAS run-off as a supplement to the GB BSC. This would be consistent with the approach under the New Electricity Trading Arrangements (NETA), when certain provisions of the Pooling and Settlement Agreement (PSA) remained in force via the 'Pool Supplement' to the BSC in order to facilitate a run-off period. It would require consequential modifications to the SAS to ensure that reconciliation for trading days prior to BETTA go-live did not occur under the SAS once the provisions of any GB BSC SAS supplement became effective.
- 5.5. Alternatively, the SAS could continue to exist as a stand-alone agreement, appropriately modified to facilitate the run-off period. This approach would minimise the impact on the GB BSC.

Administration of run-off

- 5.6. The role and functions of Scottish Settlements, as defined in part IV of the SAS, are currently fulfilled by SESL. It will be necessary for a body to continue to fulfil this role for SAS run-off. Such a body will be responsible for administering the provisions of the SAS that will remain in force for the run-off period, including the allocation of energy under the SAS for the trading days prior to BETTA go-live and administration of a SAS disputes process. Administration of the SAS during run-off could become the responsibility of any one of the following bodies:

- ◆ SESL
- ◆ GB BSCCo
- ◆ a body other than SESL or GB BSCCo, capable of fulfilling the role and functions of Scottish Settlements as defined in part IV of the SAS.

- 5.7. The following paragraphs consider these options in more detail.

- 5.8. As the incumbent, SESL could continue to carry out the role of Scottish Settlements for the run-off period. This would mean that for a period of time

following the implementation of BETTA, two settlement bodies (SESL and the GB BSCCo) would operate in parallel. The work required by Scottish Settlements will slowly but inevitably decline over 14 months and then become minimal over the period from then until the eventual termination of the disputes period under the SAS (should such a disputes window be introduced). The run-off process may be better handled by an organisation which has a stable workload and may be able to resource more efficiently the performance of such a declining role.

- 5.9. The role and functions currently undertaken by SESL could therefore be transferred to the GB BSCCo. Such an approach would be consistent with the views expressed by a number of respondents to the December 2001 consultation, who saw advantages in combining the roles currently undertaken by SESL and ELEXON Limited²⁸. Part IV of the SAS provides for the termination, resignation or removal of Scottish Settlements and its replacement with a successor. In the event that a successor to SESL, the body currently fulfilling the role of Scottish Settlements, is appointed under the terms of the SAS, SESL may be required to provide transitional support services to its successor for a period of six months. These transitional services include training, systems support and parallel running²⁹.
- 5.10. Transferring the responsibilities of Scottish Settlements to the GB BSCCo will incur costs and may require changes to the GB BSC to extend the role of the GB BSCCo in order that it can perform the role of Scottish Settlements. However, it may be appropriate to set these costs against those borne of maintaining two separate settlement bodies, should SESL continue to fulfil the Scottish Settlements functions under the SAS.
- 5.11. The third option suggested above is to transfer the role of Scottish Settlements to a body other than SESL or GB BSCCo. There is nothing written into the SAS, or indeed anywhere else, which would prevent a third party performing the role of Scottish Settlements. However, the administration of electricity settlement would appear to be a highly specialised task requiring the operation of complex systems and employment of a skilled and experienced workforce. Such skills are

²⁸ 'Appendices for the development of British electricity trading and transmission arrangements (BETTA)', Ofgem, May 2002, 38a/02, Annex 5, section A5.22.

²⁹ SAS Part IV, clause 14.2.

available in SESL and would be available in a GB BSCCo. It would therefore appear unlikely that a body other than SESL or GB BSCCo could perform the role solely for the period of SAS run-off to a standard and cost acceptable to industry participants. However, if respondents wish to propose alternatives then Ofgem/DTI would welcome their views.

Extent of reconciliation under SAS run-off

- 5.12. SESL is responsible for the operation of the Central Allocation System (CAS). Energy reconciliation is facilitated by CAS, and is explained in chapter four.
- 5.13. As has already been noted, settlement runs continue for a period of 14 months post settlement day. This suggests, therefore, that for the purposes of energy reconciliation, the SAS will be required to remain in force for at least 14 months following the implementation of BETTA and the introduction of the GB BSC.
- 5.14. During the development of the PSA run-off arrangements in anticipation of NETA, parties trading in England and Wales suggested that it may be possible to curtail energy reconciliation at eight months (third reconciliation run - R3), rather than operating for the full 14 months (final reconciliation run - RF). This option was not pursued as the potential cost of making system changes to curtail energy reconciliation under Pool run-off were deemed to outweigh any operational cost savings that would have been realised from curtailing processes early.
- 5.15. However, the circumstances facing parties to the PSA in England and Wales in the run up to NETA would seem to differ substantially from that which faces parties to the SAS for BETTA. The old Pool Stage 2 settlement systems continued to be used, subject to only minimal change, to undertake aspects of settlement in the NETA regime. By contrast, it is unlikely that the CAS will continue once SAS run-off has concluded. The administration of a full 14 month reconciliation period may unnecessarily prolong the existence of a system with a finite lifespan. It may therefore be appropriate to consider the option of curtailing energy reconciliation under SAS run off.
- 5.16. The curtailment of reconciliation would reduce the period of time that Scottish settlement systems would need to be maintained, thereby potentially realising a reduction in costs to the market. SESL has indicated that in the HH market in both settlement areas in Scotland, for the vast majority of days, the target of 99

per cent actual meter readings entering settlements is achieved at R3. Without 100 per cent accuracy, there is the potential for parties to have a larger or smaller volume of energy attributed to them than that actually consumed. However, the magnitude of error in either direction will on average be only one percent, given the likelihood that 99 per cent of energy entering settlements at R3 will be based on actual HH meter readings.

- 5.17. The NHH market makes up around 60 per cent of the overall market in Scotland, and it could be argued that estimation in the NHH market makes a greater contribution to inaccuracy than in the HH market. In the NHH market, the target for energy settled on AA's at R3 is 78 per cent, leaving 22 per cent to be settled on Estimated Annual Consumptions (EAC). SESL advises that the target level of 78 per cent AA's at R3 is currently met in both settlement areas. The target at RF is set at 97 per cent, although this target is not consistently met by all parties in each area in Scotland³⁰.
- 5.18. Curtailing reconciliation at R3 therefore increases the potential quantity of energy to be settled on EACs in the NHH market from 3 per cent to 22 per cent. SESL is of the view that the accuracy of EACs has improved due to the accumulation of four years of meter read history. SESL also indicates that the level of metering points settled on default EAC's³¹ at R3 and RF is now less than 0.5 per cent in both Scottish settlement areas.
- 5.19. Initial calculations by SESL indicate that curtailment of run-off at R3 may reduce the operating costs of Scottish Settlements during the run-off period by approximately £1 million. Such a significant saving would be achieved predominantly through the early termination of Scottish Settlements' service contracts. Such a benefit must be set against the risk of deterioration in the quality of data relating to settlement days reconciled under SAS run-off. It should also be noted that the curtailment of reconciliation under SAS run-off may adversely impact the accuracy of the allocation of settlement charges, which are considered in greater detail later in this chapter.

³⁰ This is consistent with performance levels in England and Wales, where the BSC target (set out in BSC Section S, Annex S-1) of 97 per cent AAs at RF is not consistently met by all parties in each of the 12 GSP groups.

³¹ Default EAC's are submitted by a NHH data Aggregator for NHH metering systems for which there is no value of EAC by supplier identifier.

- 5.20. In addition, curtailing reconciliation at eight months may require changes to the SAS and to CAS, although no detailed analysis has so far been carried out to establish the extent of potential changes. Any cost associated with altering either the SAS itself or the CAS, will need to be weighed against the potential administration savings to be made in reducing the reconciliation period from 14 to eight months.

Disputes under SAS run-off.

- 5.21. SAS Parties can raise a dispute in accordance with the procedures set out in Part IX of the SAS. A dispute in relation to data from a SAS registered metering system may be escalated to the SAS Disputes Panel, provided a CAS query has not been resolved in accordance with the procedures defined in the SAS. A dispute may also be raised to appeal a decision made by the PAAP, or in respect of any other matter referred to the Disputes Panel under the SAS. To date, four disputes have been raised under the SAS. Of these, three were raised by SESL and one was raised by a SAS party.
- 5.22. Procedures for raising and resolving SAS disputes will need to be in place for run-off. It may be appropriate for the existing disputes procedures to remain in force. However, at present the SAS sets no time limit on raising a dispute post final reconciliation run (RF). This can be contrasted with the disputes procedures under the PSA and the BSC, which are time limited.
- 5.23. If the existing SAS provisions relating to disputes remain in force unchanged post BETTA, it will be difficult to set a time limit on the SAS run-off period. The provisions of the SAS would potentially have to exist indefinitely, in order to enable parties to exercise their right to raise a post RF dispute. In addition, it will require the continuing existence of a body capable of administering SAS disputes. It may therefore be appropriate to introduce a time limit for raising and resolving disputes under the SAS, in order that it may be possible for the provisions of the SAS to cease to have effect following the run-off period, and to avoid any ongoing cost of maintaining a SAS disputes resolution capability.
- 5.24. A window to allow SAS parties to raise disputes would close at some point after final reconciliation (which will be either eight months or 14 months after BETTA go-live, depending on the decision reached in respect of curtailing

reconciliation) for a particular trading day. SESL has suggested that an appropriate period of time for such a window is two months. SESL has suggested an additional two months as the time period in which disputes should be resolved. This would mean that the total SAS run-off period, taking account of both the period required for energy reconciliation and raising and resolving disputes, would be either 12 months (if reconciliation is curtailed at R3) or 18 months (if reconciliation runs to 14 months).

- 5.25. Introducing a relatively short dispute initiation window would minimise the cost of administering SAS run-off but such savings must be weighed against the potential risks. Two months would appear to be a short period of time for SAS parties to track down potential data anomalies. It should be noted that the disputes window defined within the BSC³² allows for the raising of a dispute up to the third anniversary of the settlement day (effectively 22 months after final reconciliation).
- 5.26. Introducing a time limit for raising and resolving disputes under the SAS is dependent upon an appropriate SAS modification being proposed by a party to the SAS and that proposal receiving approval from the Authority.

Cost recovery

- 5.27. The 1998 project set-up costs incurred by SP and SSE and the means of recovery of those costs (settlement charges) are outlined in chapter four of this document. As at April 2004, £10.3 million of the 1998 project set-up costs will remain outstanding to SP and SSE.
- 5.28. The settlement charges are also the means by which SESL recovers its annual operating costs. During the run-off period, operating costs will continue to be incurred by the body responsible for carrying out the role of Scottish Settlements, and it will be necessary for the party appointed under the SAS to continue to have the right to recover these costs.
- 5.29. It will be necessary therefore to establish a mechanism that will provide for the recovery of the following costs post BETTA go-live:

³² BSC Section W, clause 1.2.5.

- ◆ the outstanding recoverable development costs relating to the 1998 Scottish settlements project incurred by SP and SSE, and
- ◆ ongoing operating costs that will be incurred by the body responsible for administering Scottish settlements during the run-off period.

5.30. Ofgem/DTI will be publishing shortly a separate consultation document on the topic of cost recovery across the new arrangements. That document will address the question of the recovery of costs of BETTA development. This consultation considers only the outstanding 1998 costs and run-off operational costs in relation to the SAS.

1998 costs

5.31. It seems appropriate to Ofgem/DTI that SP and SSE should be allowed to recover the £10.3 million recoverable development costs that will be outstanding as at April 2004, the anticipated BETTA implementation date³³. These costs are currently recovered as a portion of the settlement charges applied to parties based on energy volumes accrued under the SAS. It should be noted that settlement charges under the SAS are recovered monthly on the basis of actual energy generated or supplied on each settlement day. The termination of SAS processing in respect of days after BETTA go-live would therefore remove the current mechanism for recovery of these costs.

5.32. It will therefore be necessary to establish an alternative mechanism to enable SP and SSE to recover the £10.3 million outstanding recoverable development costs.

5.33. Some parties have argued that these costs should be recovered through any mechanism established to recover the capital expenditure incurred in the implementation of BETTA. However, it would be inappropriate to treat these costs as BETTA implementation costs, as these costs are associated with the implementation of the 1998 project in Scotland.

³³ This is subject to the Electricity (Trading and Transmission) Bill being introduced in the current Parliamentary session and Royal Assent to the E(TT) Bill by September 2003.

- 5.34. In addition, it should be noted that the equivalent England and Wales 1998 development costs are currently being recovered from parties trading in England and Wales alone, and this recovery will be complete in March 2003.
- 5.35. Ofgem/DTI do not, therefore, consider that it is appropriate to treat the recovery of these outstanding 1998 set-up costs as capital expenditure costs relating to the implementation of BETTA.
- 5.36. It may be possible to continue to recover these costs from parties trading in Scotland on the basis of volumes traded post BETTA, continuing to split recovery 70 per cent from suppliers and 30 per cent from generators in Scotland. This will require the GB BSCCo to have systems in place capable of identifying trades in relation to generation sites and bulk supply points in Scotland and calculating bills based on this data. If such systems are established, GB BSCCo could calculate the amounts payable, and administer the flow of funds between parties, but the costs would not appear in the balance sheet or profit and loss account of GB BSCCo. This is consistent with the approach adopted by ELEXON Limited, as BSCCo, in facilitating the recovery of 1998 costs remaining outstanding to the PES's at NETA go-live. However, such an approach may require changes to the existing settlement systems to identify the data required and the costs that would result cannot be identified at present.
- 5.37. Alternatively, it may be appropriate to recover these costs from parties trading in Scotland prior to BETTA go-live, and allocate costs to be recovered from individual parties according to volumes traded in a certain period before BETTA go-live. This is the approach that Ofgem/DTI consider most appropriate in respect of recovering these costs. Ofgem/DTI consider that 6 months prior to BETTA go-live is a reasonable period upon which to base an allocation of costs to individual parties.

Ongoing operating costs

- 5.38. During the SAS run-off period, operating costs will continue to be incurred by the body responsible for carrying out the role of Scottish Settlements.

- 5.39. At present, SESL recovers its annual operating costs via settlement charges. As with the recovery of outstanding development costs, the mechanism for recovering the operating costs for Scottish Settlements will cease with the termination of SAS processing in respect of settlement days after BETTA go-live.
- 5.40. It will therefore be necessary to establish a mechanism for recovery of the operating costs of Scottish Settlements post BETTA.
- 5.41. During PSA run-off, PSA operating costs were recovered from BSC parties as a bundled element of the BSC charges. As parties to the BSC were very similar to parties to the PSA, the PSA run-off costs fell within a reasonable degree of accuracy upon those benefiting from their operation. One option for the recovery of SAS run-off costs is to recover these as an element of the GB BSC charges.
- 5.42. Recovering Scottish Settlements' operating costs as an element of the GB BSC charges during run-off, will spread these costs across GB. Early indications from SESL suggest that the budget required for the operation of Scottish settlements for the whole of the run-off period will be around £3.5 million, reducing to £2.5 million if reconciliation is curtailed at R3.
- 5.43. Alternatively, as with the proposal for recovering outstanding 1998 costs, it may be possible to select an appropriate period preceding BETTA go-live and use the volumes traded by parties in Scotland in this period as a means of calculating the share of operating costs during run-off to apply to these parties. In addition, costs relating to the reconciliation of energy trading for days in England and Wales prior to BETTA could be separated from the GB BSC charges. Such an approach would avoid any cross subsidies, although the additional costs borne of establishing such arrangements may outweigh the benefits of full cost reflectivity.

Options for SAS post run-off

- 5.44. At the expiry of run-off, the provisions of the SAS will no longer be required. It is therefore appropriate to consider whether the SAS run-off arrangements

should provide for the termination of the SAS at the end of run-off, or whether it is more appropriate simply for the provisions of the agreement to cease to have effect post run-off.

- 5.45. The SAS provides that the agreement may be terminated by agreement in writing of all the parties to it and with the consent of the Authority³⁴. It may be appropriate for parties to agree in advance of the implementation of BETTA that the agreement will terminate at the expiry of run-off, subject to the consent of the Authority.
- 5.46. However, it is not necessary for run-off to provide for termination of the SAS, as long as run-off establishes that the functions of the SAS will cease to have effect post run-off. If the SAS is not terminated, all SAS parties could choose to resign from the agreement at the expiry of run-off.

Licence implications

- 5.47. It is a standard condition of supply and generation licences to become a party to and comply with the SAS, of transmission and distribution licences to comply with the SAS, and it is a licence obligation on SPDL and SHEPDL to provide the SAS.
- 5.48. It will not be possible to remove these licence obligations at BETTA go-live, as during the run-off period it will be necessary for certain provisions of the SAS to remain in effect and for licensees to be a party to and comply with the SAS. However, it will be necessary to amend the existing licence obligations to take account of the SAS run-off period.
- 5.49. Amendments to the wording of the standard licence conditions will be informed by the outcome of this consultation in relation to the arrangements necessary to give effect to SAS run-off. If parties decide to provide for the termination of the SAS at the expiry of the run-off, licensees will be required to comply with and be a party to the agreement for as long as it is in force. If no provision is made for terminating the SAS, licensees will be required to comply with remain a party to the SAS only for the purposes of run-off. Therefore, at the end of run-off,

³⁴Part IX, clause 128.2.
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although the SAS would still exist, there would be no licence obligation on parties to comply with it and all parties could choose to resign.

- 5.50. The special licence conditions in the licences of SPDL and SHEPDL will have to be amended to reflect the obligation on these two licensees to provide the SAS only for the run-off period. At the expiry of the run-off period, these conditions will be obsolete and Ofgem /DTI anticipate that they can be removed from the licences of SPDL and SHEPDL.

Views invited

- 5.51. Ofgem/DTI invite views on the following:

- ◆ the appropriate vehicle for the SAS run-off provisions, ie the continuing existence of the SAS as a stand alone document, or the incorporation of certain provisions of the SAS as a supplement to the GB BSC
- ◆ the appropriate body to undertake the role and functions of Scottish Settlements during the SAS run-off period
- ◆ the appropriate duration of the reconciliation process relating to energy initially allocated prior to BETTA go-live
- ◆ a potential amendment to the SAS disputes process to introduce a time limit for raising a dispute and on the appropriate duration of such a time limit
- ◆ an appropriate time limit for resolving disputes under SAS run-off
- ◆ the proposal to recover outstanding 1998 recoverable development costs from parties trading in Scotland prior to BETTA go-live, allocated according to volumes traded during the six months prior to BETTA go-live
- ◆ an appropriate mechanism to enable the body responsible for carrying out the role and functions of Scottish Settlements to recover its operating costs during the run-off period

- ◆ appropriate amendments to the standard electricity licences and to the licences of SPDL and SHEPDL to provide for SAS run-off, and
- ◆ whether the SAS should be terminated at the end of run-off, or whether it is more appropriate for the agreement to remain in force but provide for it to cease to have effect.

6. Way Forward

- 6.1. In view of the issues discussed in chapter five, it is likely that in order to facilitate a SAS run-off period and provide for the SAS either to terminate or cease to have effect post run-off, a number of changes will be required to the SAS as currently drafted. SAS modifications are taken forward by the SAS Modification Panel in accordance with defined procedures, and approved or rejected by the Authority.
- 6.2. It is anticipated that as follow-up to this paper, a decision document will be published in March 2003. The decision document will discuss responses to the issues raised in this paper, and set out what changes to the SAS Ofgem/DTI anticipate will be required to facilitate the implementation of BETTA.
- 6.3. If respondents are of the view that SAS modifications are necessary to facilitate SAS run-off under BETTA, Ofgem/DTI anticipates that these modifications will be taken forward following the modification procedure established in the SAS. In line with this procedure, any proposed modifications will only be implemented following approval by the Authority.
- 6.4. As discussed in chapter five, it is likely that amendments will be required to the standard electricity licence conditions that require licensees to comply with and become a party to the SAS, and to the licence conditions on SPDL and SHEPDL requiring them to have the SAS in force.
- 6.5. Ofgem/DTI will set out in the March 2003 decision document the licence amendments that it anticipates will be required. These licence amendments will be progressed in parallel with the other licence amendments that it is anticipated will be required for BETTA³⁵.

³⁵ Ofgem/DTI will publish shortly a consultation on the changes required to the standard electricity generation, distribution and supply licences under BETTA, and separately a consultation on the changes required to the standard electricity transmission licence under BETTA.