CfD Day 3 – Reserve Fund Management and Levy Reconciliation

9th October 2013

Attendees (as per sign-in sheet)

1. Introduction
Introduction - The purpose of the workshops is to provide stakeholders with an understanding of how EMR processes can be implemented in practice. The focus will therefore be on process rather than policy. - The process maps should help people understand the interfaces between different stakeholders. - There have been requests for more detail on the process maps specifically around calculations and tasks. Updated process maps will follow. - PwC will deliver a detailed operating model which illustrates specific customer journeys and their engagement in the CfD processes. - No comments will be attributable to individuals. - Agenda change; the workshop on the 23rd October will now be combined with the sessions on the 16th and 17th.

2. Fixed Rate Levy
Policy context - The levy year will run from 1 April – 31 March - Payments to suppliers will not match those to generators. Therefore a levy fund is required to balance out payments, manage mis-forecasting and unexpected events. - Payments into the reserve fund will be based on July to June timetable which is a different timetable to that of the levy year. - The CfD levy will be set in legislation with a formula, rather than a specific amount as the exact amount owed cannot be known until all data is finalised. - To calculate how much is payable by suppliers, the counterparty will forecast the total CfD costs for the year and set a unit cost fixed rate (£/MWh) – this is also known as a payment on account (PoA) rate. - The levy formula will be written into legislation and cannot be changed easily (has to go through Parliament).
Issues / questions - Industry asked how the counterparty will forecast the Supplier levy? The counterparty will produce a model that will calculate the unite cost fixed rate and reserve fund costs. - Industry would like to be consulted on about the model – both the weighting applied to each scenario, the way it is calculated and the sensitivities used to calculate the reserve fund - Industry asked if there be some consistency between the CfD model and the RO model? DECC explained that where possible they are working towards consistency between the two and the CfD will aim to be an improvement on the RO. - DECC would like to hear views on the fixed rate levy and on possible alternatives.

3. Reserve Fund
- A supply of working capital is needed to smooth payments and mitigate against inherent timing and uncertainty risk. - Each supplier has a virtual reserve fund balance. Payments made into the fund by a supplier will be tracked to determine individual reserve fund balances (although money will be held and used collectively)

- Payments in the reserve fund are made up of:
  - Lump sum payments
  - Levy payments – the difference between what is paid in by suppliers and out to generators.
- Each supplier's contribution to the opening balance will be based on their market share for the latest monthly trading data.
- Surplus funds can be carried over to start the reserve fund the following year. However, surpluses cannot be carried over to reduce the following year's levy rate.

4. Reserve Fund Timing

Overview

- Suppliers will pay the difference between the reserve fund closing balance for the current levy year and the opening balance for the following year.
- Full payment for the year is due in advance – suppliers cannot pay monthly.
- If the balance at the end of the year is exactly what is needed for the following year then no more credit is needed. If there is a surplus, the supplier is refunded the excess. Equally if a supplier's account is in deficit, the supplier will be required to pay the difference when the next payment is due.
- Suppliers will be notified by 6 January each year of the size of the next year's reserve fund and the estimated closing balance for the current year
- The actual payments for the following year's reserve fund will be notified by 20 May
- Payments will be made by 1st July each year
- The first year will be different as the reserve fund will have to be filled in before 1st July.

Issues / questions

- Following the consultation document, an impact assessment will be released which will provide an estimate for the size of the reserve fund.
- Industry requested a timeline for the reserve fund requirements, reconciliation and fixed rate levy dates.
- If a new supplier enters the market they are obliged to pay the fixed rate levy and make a contribution to the reserve fund. It is expected that they will not be expected to pay immediately so that some supply data is available before their contribution is calculated. Industry suggested that one way to determine how much a new supplier must pay should be based on the supplier's own target market share over the first year of operation. DECC are interested in getting industry's input on this.
- New suppliers would be obliged to make levy payments and contribute to the Reserve Fund. Should the new supplier's Reserve Fund contribution be sized according to their plans, as opposed to their month 1 market share? Another solution would be a monthly top-up or triggers for new suppliers? DECC are very interested in getting industry's input on this.

5. Reserve Fund Management

Overview

- 1 – 4 boxes covers the settlement agent calculating what the suppliers owe.
- The middle section covers the supplier being invoiced and making payments.
- The final section covers the disputes process and what happens if suppliers are late in paying.

Process Map

- 1. SA requests supplier volume data in order to calculate funds owed for the reserve fund.
- 2. BSC code notifies SA if there is a new supplier who needs to make a payment.
- 3. BSC code provides the SA with supplier volumes (actual amount of electricity supplied in the relevant period by individual suppliers as a proportion of the total reconciled supply).
- 4. Once supply data has been provided to SA (for both new and existing suppliers) the SA calculates what sums are owned to or by each supplier based on the closing balance.
- 5. And 6. Suppliers are invoiced for the difference
- 11. Suppliers make electronic payment for the invoice reserve fund

- 7. Suppliers have made their payments and SA checks that all contributions have been received
- 8. SA chases up suppliers who are late in paying their reserve contribution.
- 12. A supplier who raises a dispute or query discusses and resolves the query with the Settlement Agent. The supplier is required to pay any invoices until the query has been resolved.
- 9. and 10. If the supplier still does not pay then the SA enforces payment and advises the Counterparty (and Ofgem) of non-payment.

Issues / questions

- The interest rate for late payments is 3.5% above the Bank of England base rate.
- Suppliers will be notified of payment requirements by May and payments will be required by 1st July
- An attendee asked whether Elexon's invoicing systems will be used. DECC assured industry that systems used will be designed to fit in with current systems where possible. Input was sought on what systems industry would like used.
- An attendee asked who would run the dispute process. Response: the counterparty. If the dispute is with regards to data, the dispute would be through the BSC
- If there is a metering/volume dispute within year, attendees suggested that there might need to be a consideration of the materiality threshold before potentially recalculating the size of the RF for all suppliers mid-year.
- An attendee asked what the rational is for separating the insolvency reserve fund and the reserve fund? Insolvency reserve fund is there in case a supplier defaults and their collateral has been exhausted. The reserve fund is normal cash flow management, BAU fund – smoothing payments, forecasting errors etc.
- An attendee suggested the option of providing more collateral rather than a large insolvency reserve fund.
- An attendee asked whether they could buy insurance rather than provide more capital? DECC would like industry to raise this during the consultation process.
- The process map doesn't reflect that the reserve fund could fluctuate depending on how payments coming in from suppliers compares to payments going out.
- An attendee would like to be notified if their monthly payments are likely to increase due to a depletion in the reserve fund. Currently no trigger point or threshold has been set although DECC agreed that they could look at this in more detailed.
- Counterparty provides a quarterly report on utilisation of the reserve fund so suppliers have transparency of the level of the fund and whether further funds will be required.
- An attendee suggested that more transparency is needed on the process to mitigate risks, such as increased payments and 'one-off shocks'
- An attendee suggested reduced payments for generators depending on current cash flow in order to mitigate against suppliers going bust. DECC believed that this would not be viable.

6. Reserve Fund Estimation

Overview

- Suppliers will be notified of the estimated closing balance in the reserve fund.
- At the same time, the fixed rate and the size of the reserve fund of the following year will be announced.

Process Map

- 1 & 2 can be done in parallel. Counterparty uses the forecasting model to forecast the current year end reserve fund position and to forecast the size of the reserve fund for the following year. This communication will be communicated to the whole industry, not just suppliers.
- 3. Counterparty informs SA of this information
- 4. & 5 SA estimates how much each supplier will have the reserve fund at year end and will calculate an estimate of their required adjustments.
- 6. The SA notifies the suppliers what they estimate the difference to be.

Detail

- The invoice will be sent in mid may as it will then be known what the Generator payments have been for the year.

7. Levy and Reserve Fund Reconciliation

Overview

- It takes 14 months for full reconciliation

In Year Adjustments

- Any adjustments to supply data (MWh) received between 1 April (FY1) – 30 April (FY2) for the year in question will be adjusted through daily bills at the PoA rate
- Any adjustments to generation data will be through a debit or credit to the reserve fund – apportioned across each supplier during the reserve fund reconciliation at the end of the year when the complete year's Supplier data is available.

Post Year Adjustment

- Any adjustments to total supply data or generation data (from May onwards) will be adjusted through the reserve fund on a regular basis by crediting or debiting individual supplier's virtual reserve account.
- The reserve fund would be reconciled in May of each year, any balance will be repaid to suppliers.
- Suppliers would receive quarterly statements with details of their virtual reserve fund balance and levy paid to date.

Process Map

- 1. & 2. SA uses most recent reconciled data to calculate what the CfD how much has been paid to generators for the year in questions and how much electricity has been supplied (net of EIIs) for the year in question
- 3. SA calculates the revised payment on account (the fixed rate) for the year in question
- 4. The SA applies this revised rate to the reconciled supply data in order to calculate the amount due for the year in question.
- 5. The SA compares this amount to what the supplier actually paid.
- 6. Any difference is posted into each supplier's ledger in the reserve fund for the year in question.
- 7. The SA determines if all the data has been finalised and whether any further reconciliations are needed. If further reconciliation is needed or if there is a dispute then it loops back to the beginning of the process. If all the data is fully reconciled then move onto box 8
- 8. SA notifies the counterparty that all data is fully reconciled and of the total CfD costs and total electricity supplied (net of EIIs) for the year in question.
- 9. The counterparty calculates the actual final level rate for the year
- 10. The SA notifies suppliers of the actual finalised levy rate for the year in question.

Detail

- 7. Industry would expect that government would be looking to publish final figures at a set date.
- The relationship with the levy control framework needs to be clarified. There may be a need to adjust the rate based on the LCF from two years previously
- Any residual would be reconciled in the reserve fund calculation

8. Strawman – CfD Billing Notices & Invoices

Overview

- Elexon put together a strawman billing notice to facilitate discussions in the workshop
- This was based on Elexon's understanding and was not cleared by DECC.
- Elexon outlined some of the key documents that will be needed to undertake a CfD settlement. An overview was included for each financial document
- The documents were not comprehensive of all settlement agents flows and reports

Physical Reporting Mechanisms

- Elexon propose to issue reports to Parties as emails with attachments in two formats; PDF and XML
- This is in line with how Elexon work in the BSC Code
- There may be other mechanisms for accessing the data e.g web page. This needs to be confirmed as Elexon gain a further understanding of the requirements

Invoice / Credit Notes

- Any amounts payable will be sent via an invoice. Any amounts receivable will be sent via a credit note.
- Each invoice or credit will follow the standard format showing line items and net amount payable.

Main CfD Payments

- For CfD payments a credit note will be sent to the generator along with the billing settlement which will appear as an appendix to the CfD.
- For Supplier levy payments a backing sheet will be included.
- Collateral / credit will be required
- Suppliers will also receive reserve fund notices

Flow of reports to suppliers

- The diagram illustrates key documents that will be sent by the CFD Settlement Agent to suppliers
    - Fixed Levy (in year) accompanied by a backing sheet
    - Reserve fund notice (out of year adjustments for levy payments) – this will not apply to the operational levy.
    - Reserve fund annual reconciliation (as well as an estimate in January)
    - Insolvency Reserve Fund Annual Reconciliation – any adjustment
    - Insolvency Reserve Fund Annual Mutualisation – across suppliers
    - Collateral Notice – this could be sent daily.
    - Request for Collateral – sent if more collateral is required.
    - There will ad hoc invoices for any ad hoc payments.

Flow of reports to generators

- The diagram illustrates key documents that will be sent by the CFD Settlement Agent to generators
    - CFD Payments
    - Collateral Notice
    - Request for Collateral

Points to consider…

- Should the CfD Settlement Agent aggregate very small invoices (up to threshold) as done under the BSC, to lessen administrative burden (particularly on small or existing Parties?)
    - Industry agreed that this was sensible but questioned what would be considered as “small”. Expected that £500 would be seen as small.

- Elexon proposed that Billing Periods will equate to Settlement Days (notwithstanding suggestion in draft CfD that Billing Period should run from 23:00 to 23:00).

- Elexon would like to discuss the mechanics of invoicing default interest.

- Only suppliers pay for Operational CfD costs.

- Industry asked how transparent information would be and whether supplier specific data would be published to the whole market.

9. Strawman Document

To CfD Generators

- The invoice or credit note may include multiple CfDs and Settlement Date, each of which will have separate line items. The invoice or credit note will be accompanied by a Billing Statement, as per the contractual requirements.
- Please see Elexon's strawman for details on information provided in each CfD contract, billing period and settlement period (30 mins).
- Where payments are being made to the Generator, Elexon expects that default interest charged won't be required (as processes are designed to ensure that Counterparty is able to make timely payments).

To Licensed Suppliers - Overview

- Fixed Levy Invoice; each invoice would include the supplier obligation payment due and the operation levy payment. The invoice would also be accompanied by a backing sheet.
- Industry highlighted that having a fixed rate per MWh would lead to unnecessary reconciliation.
- DECC would like feedback on how industry would feel if a notification that a supplier has gone into default being published on the website.
- DECC would find it useful to know what industry would be able to provide to demonstrate material doubt

To Licensed Suppliers - Reserve Fund Annual Reconciliation

- Overview of the detail required in the invoice outlining the closing balance for the current year's insolvency reserve fund and the opening balance for the new year
- There will be two version of this yearly;
  - Published in January there will be an estimate of what suppliers will be expected to pay
  - In May/June there will be an actual reconciliation.

- It is unlikely that a report with estimates will be published this January as payments may not start until April 2015. Views on this was sought in the consultation.

To Licensed Suppliers - Insolvency Reserve Fund Annual Reconciliation Invoice

- When the insolvency reserve fund is called upon the mutualisation process will be triggered and an invoice will be issued to each supplier
- Summary of backing sheet detail provided
- N.B. within the example of insolvency reserve fund reconciliation, the last line should read "The CfD Settlement Agency therefore issues an invoice for £5k"

To Licensed Suppliers – Reserve Fund Notice

- Subset of the reserve fund annual reconciliation backing sheet
- N.B. industry suggested changing the word 'notice' in the title

To CfD Generators or Licensed Suppliers – Collateral Notice

- The notice is assumed to be the same for Supplier/Generator
- Details and backing sheet overview provided

To CfD Generators or Licensed Suppliers – Request for Additional Collateral Notice

- Used to call the initial lodging of collateral
- Supplier/Generator outlined key details: Company Name, Date of Notice etc.

To CfD Generators or Licensed Suppliers – Generic Invoice/Credit Note

- As standard invoice/credit note

Issues / questions

- There was a request for Elexon to make a mock-up of a billing statement rather than listed items
- Need to determine how the billing would work between different entities and the associated CfD contracts
- Industry discussion around billing of legal entities and net billing, particularly regarding project finance arrangements. DECC will consider this issue.

- DECC asked how industry would feel if they published information on whether a supplier is in default on the website? Industry responded that confirmation would be needed on the data and assurance that it is correct, with all dispute avenues exercised. A proportionate reaction is needed to credit default- question was asked as to whether there was scope for material doubt - DECC responded that there is a query period after the invoice is received to clarify
- Industry happy to talk through with DECC how to operationalise for the Supplier Obligation, reserve fund and collateral and to establish systems that incorporate CfD
- Industry highlighted that it would be useful to have some sort of test run as by 2015 it is likely that suppliers will be calculating payment manually rather than investing in systems.
- Industry voiced concerns about how over collection will be portrayed by the media.
- Industry asked for clarification on what will Ofgem require in terms of reporting. DECC to clarify.
- On Industry requests for clarification on the insolvency fund, where the fund isn’t sufficient there will be an additionally mutualisation payment request on suppliers. Government underwriting is not an option considered by the Treasury to mitigate against the inherent risk of changing energy prices and the volatility of generation
- Reconciliation payments are needed from if a supplier defaults and if the supplier in question is in surplus how will this asset be paid out (defaulting supplier could have paid excess/under paid). Confirmation is needed from DECC.
- If a supplier wanted to leave the market they would have to wait until final reconciliation to receive any outstanding amounts
- Industry want time to consider the consultation document before any wash up sessions