



SEM TRADING AND SETTLEMENT CODE

Supplier Suspension Delay Period and Generator Suspension Delay Period

CONSULTATION PAPER

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Introduction

The SEM Trading and Settlement Code (TSC) was commenced on 3rd July 2007, when the Framework Agreement was signed by the original signatories. The TSC specifies that the Regulatory Authorities shall determine the Supplier Suspension Delay Period and the Generator Suspension Delay Period from time to time¹. The purpose of this consultation is to lay out the Regulatory Authorities' thinking on the values that should be adopted for these two parameters and to seek views from interested parties.

Section 1 of this consultation paper sets out the TSC provisions in respect of the suspension of Participants' Units. Section 2 of the Paper then describes the effect of the Supplier Suspension Delay Period on the calculation of the Required Credit Cover for Participants. Section 3 of the paper explains the legal framework for the provision of a Supplier of Last Resort in Northern Ireland and in Ireland. Sections 4 and 5 explain the proposed Supplier Suspension Delay and Generator Suspension Delay Periods. Section 6 mentions the possibility of insurance as an alternative to credit cover in the Pool. Section 7 describes the next steps in this process.

In summary, the key views expressed in this paper are:

- the Pool is not and cannot be a fully collateralised market since, under some circumstances it may be impossible to stop a Participant trading within a predetermined period of time and given that Pool prices cannot be known with certainty;
- for each additional day in the period for which credit cover has to relate (the Undefined Exposure Period) the increase in the total Required Credit Cover across all Participants would be about €12 million (roughly ½% of the annual market turnover) if no Settlement Reallocation Agreements were lodged;
- the Supplier Suspension Delay Period is proposed to be 14 days; and
- the Generator Suspension Delay Period is proposed to be 7 days.

Appendix 1 of this paper describes the current processes, which are still under development in both jurisdictions, for the implementation of an Supplier of Last Resort Direction in the wholesale market.

The Regulatory Authorities welcome all comments on the proposals in this paper and in particular on the key points in the summary above. Comments should be sent, preferably in electronic form, to:

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¹ See TSC paragraph 2.249.

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The closing date for comments is Friday, 17th August 2007.

1. TSC Suspension Process

Under the TSC, a Suspension Order is an order from the Market Operator instructing a Participant to cease trading in the Pool in respect of the Unit or Units identified in the order. The Market Operator may issue a Suspension Order² in respect of any or all of a Participant's Units under certain defined circumstances, subject to the prior written consent of the Regulatory Authorities. In addition, the Market Operator must issue a Default Notice and a Suspension Order in respect of all of a Participant's Units if a Credit Call is made and the Participant's Credit Cover Provider fails to meet such a demand or the Participant fails to provide the Required Credit Cover within the required timescales³. In these latter cases, the consent of the Regulatory Authorities is not required. In practical terms these latter circumstances would come about when a Participant has failed to pay an invoice and either its credit cover failed or, after a successful call on its credit cover, the Participant failed to restore the Required Credit Cover.

Any Suspension Order may not come into effect in relation to any Supplier Units before the expiry of the Supplier Suspension Delay Period and in relation to any Generator Units before the expiry of the Generator Suspension Delay Period⁴. The key purpose of these delay periods is to provide time during which the Regulatory Authorities may investigate the underlying issues which led to the Participant defaulting and to consider and determine what action should be taken (if any) and, if possible, to enable the Participant to correct the default. Paragraph 2.244 of the TSC also provides that, during the period before the Suspension Order comes into effect, the Regulatory Authorities may instruct the Market Operator to amend or lift the Suspension Order in relation to any or all of the Units concerned.

In relation to any Supplier Unit, paragraph 2.244 of the TSC also provides that a Suspension Order may not come into effect unless the relevant Regulatory Authority has directed that all demand represented by that Supplier Unit should be met by the Supplier of Last Resort. There are two reasons for this: firstly, to ensure that if a Suspension Order takes effect, the end customers or consumers represented in the Supplier Unit will not be left without a supplier; and secondly, to ensure that all demand in the wholesale market is allocated to a Participant. Accordingly, unless a Supplier of Last Resort is directed, the Suspension Order in respect of such a Supplier Unit can never come into effect. The Participant in respect of that Supplier Unit will continue to accumulate liabilities in respect of its Supplier Unit until a Supplier of Last Resort is so directed, or until the Participant remedies its default and the Suspension order is removed by the Market Operator⁵. However, were the supplier concerned to sell its customer base to another supplier, all the meter readings associated with the

² See TSC paragraph 2.246.

³ See TSC paragraph 2.243.

⁴ See TSC paragraph 2.244.

⁵ See TSC paragraph 2.255.

suspended Supplier Unit would be moved to another Supplier Unit and the Suspension Order could come into effect until such a time as the Participant remedies its default⁶. In addition, as mentioned above, the Regulatory Authorities may instruct the Market Operator to amend the Suspension Order and such an amendment could include a delay to the date on which it shall take effect.

It is therefore impossible to define a maximum period of time at the end of which a defaulting Participant can certainly be removed from participation in the Pool. In addition, even if such a period of time could be defined, neither the future energy volumes nor the future energy prices in the Pool can be forecast exactly. It is therefore not possible to provide for full collateralisation of the market. There are circumstances where a Participant's credit cover may fail or be exhausted while the Participant continues to accrue debts. Such debts may not be recoverable and would fall on SEM Creditors as set out in paragraph 6.57 of the TSC.

2. Effect on Credit Cover

Under the TSC⁷, the Required Credit Cover for each Participant is made up of two components: its Actual Exposure and its Undefined Potential Exposure. The Actual Exposure consists of the amounts in any Invoices issued but not yet paid and the amounts in any Settlement Statements for which no invoice has yet been issued. The Undefined Potential Exposure consists of potential exposure from accrued obligations which have not yet been included in any Settlement Statement but which are likely to be accrued during the Undefined Exposure Period (which is the period before the Participant's Units can be suspended). The Market Operator is obliged⁸ to determine the Undefined Exposure Period in relation to Billing Periods and to Capacity Periods for every Working Day. These Undefined Exposure Periods will form the basis for the calculation of the Undefined Potential Exposure component of the Required Credit Cover for each Participant.

Clearly, in the Market Operator's calculation of the Undefined Exposure Period, the Supplier Suspension Delay Period will be a major determinant since, on the assumption that a licence will not be revoked before the end of the period, no Supplier Unit can be suspended (and thus cease to accumulate debts) until the expiry of that period. Liabilities will cease to be allocated in respect of a Supplier Unit when there are no longer any Meter Point Registration Numbers (MPRNs) allocated to that Supplier Unit. The removal of MPRNs from a Supplier Unit can be effected by a number of mechanisms including customer churn and sale of customer base by the supplier concerned but the most direct mechanism that does not require the consent of the Participant is a Supplier of Last Resort Direction.

⁶ Note that some clarification of paragraph 2.244 of the TSC may be required in relation to a sale of customers.

⁷ See TSC paragraph 6.172

⁸ See TSC paragraph 6.173

The calculation of the Required Credit Cover for the Undefined Exposure Period for Standard Participants⁹ is based upon a statistical analysis of the components of the Undefined Potential Exposure over a Historical Assessment Period. At this point in time, historical data does not exist to enable an accurate assessment of the scale of this component of Required Credit Cover to be made. However, sufficient forecasts have been produced to enable an approximate assessment to be made.

An assessment of the likely effect on Required Credit Cover has been carried out, based upon the following assumptions:

- an estimate for the Capacity Payment Demand Price of €16.24 per MWh (which is based upon the estimated Capacity pot of 570 Million Euros¹⁰, divided by an estimated annual demand for energy of about 35 TWh¹¹);
- an average SMP of €51.28 (based upon the benchmark price for 2008¹² of €67.52 per MWh less the above estimated Capacity Payment Demand Price of €16.24 per MWh);
- an estimate of 40% standard deviation on these values and an assumed Analysis Percentile Parameter of 1.96¹³ (equivalent to 95% probability of the value not being exceeded);
- an Imperfections Charge of €3.113 per MWh¹¹ and
- a Market Operator Variable Charge of €0.597 per MWh¹¹

Based on these assumptions, the element of Required Credit Cover required to cover the anticipated future risks (over the Undefined Exposure Period) would be approximately €124 per MWh per day of the Undefined Exposure Period. Thus, for an average daily energy demand of about 95 GWh (35 TWh / 365 days), the additional Required Credit Cover (across all Participants) for each additional day of Undefined Exposure Period would be about €12 million. This calculation takes no account of any Settlement Reallocation Agreements which would be likely to be put in place by Participants to minimise their Required Credit Cover.

3. Supplier of Last Resort

The process of removing a Defaulting Participant from the ability to incur further debts in respect of its Supplier Units requires the removal of all the MPRNs from the relevant Supplier Unit(s). If such MPRNs were not allocated to any Supplier Unit, the energy concerned would be allocated in the

⁹ See TSC paragraphs 6.188 to 6.228

¹⁰ from AIP-SEM-07-239 Indicative 2008 Annual Capacity Payment Sum

¹¹ from AIP-SEM-07-247 SMO Revenue Submission 2007 Final version

¹² See "Public Service Obligation Levy, Proposed 2008 Charges, Proposed Decision", CER 70/87

¹³ Note that the Regulatory Authorities have not yet approved the Market Operator proposal for the value for the Analysis Percentile Parameter and this value should not be interpreted as any indication of any value that may be under consideration.

wholesale market to the relevant Error Supplier Unit. In order to allocate such MPRNs to another Supplier Unit, unless a failing supplier decides to sell its customer base to another supplier, a Supplier of Last Resort Direction is required. Such a direction may be associated with the removal of the supplier's licence. The legal frameworks for the issue of such a direction in each jurisdiction are outlined below and the processes that would result in the wholesale market are set out in Appendix 1. It should be noted that work is continuing on such processes in both jurisdictions and the Regulatory Authorities may consult further on this matter.

The relevant Regulatory Authority in each jurisdiction has the power, under defined circumstances, to issue a direction that the customers of a failing supplier should be taken over by a designated Supplier of Last Resort. The effect of such a direction is to put in place a deemed supply contract between each of the customers of the failing supplier and the Supplier of Last Resort (SoLR), which the SoLR can rely on for billing purposes.

Northern Ireland

In Northern Ireland the Electricity Regulations (Northern Ireland) 2007 have amended the provisions of the Electricity (Northern Ireland) Order 1992 to replace its Schedule 6 with a new Electricity Supply Code. The new Electricity Supply Code contains a paragraph 3, "Deemed Contracts", which provides for the existence of deemed contracts where contracts for supply to premises do not exist.

The logical steps in the SoLR process for Northern Ireland are:

1. the revocation of a supply licence would trigger the processes for the removal of the MPRNs from that supplier;
2. after the removal of the MPRNs, bad debt for the supplier would no longer accrue; but the liability for such MPRNs would continue to accrue and would need to be allocated to another supplier by;
3. the Supplier of Last Resort Direction obliging the appropriate supplier to register the MPRNs.

The conditions for the revocation of a licence from a supplier in Northern Ireland are set out in the supply licences. The key circumstances when a supply licence can be revoked are when the supplier:

- (a) has failed to comply with an enforcement order or failed to pay a financial penalty and has not remedied that failure within the specified period;

- (b) is unable to pay its debts (within the meaning of Article 103(1) or (2)¹⁴ of the Insolvency (Northern Ireland) Order 1989), has a voluntary arrangement proposed in relation to it or enters into any scheme or arrangement;
- (c) has a receiver appointed in respect of its assets or undertaking;
- (d) has an administration order made in relation to it; or
- (e) passes any resolution, or becomes subject to an order, for winding up.

There is clearly a significant period of time from the point of the first failure to pay by a Participant (assumed to be in respect of its Supplier Units) until such a Participant in Northern Ireland could be removed from the ability to incur further debts because of the need to effect the removal of its licence in the same timescale. However, there are steps that could be taken to minimise this period of time. Were a “statutory demand” (as referred to in the Insolvency (Northern Ireland) Order 1989) to be delivered to the Defaulting Participant as soon as it had an undischarged debt to the SEM Creditors, then if the demand had not been paid within 21 days, that could trigger action by the NIAUR to commence revocation of the supply licence. Note that such a statutory demand could not properly be issued until there was a debt resulting from the Participant's failure to replace its credit cover. At present revocation of a licence requires 30 days notice. In Great Britain, the equivalent notice period used to be 30 days but has been reduced to 24 hours.

In addition, the Insolvency (Northern Ireland) Order 1989 defines the minimum statutory demand as £750; however, the supply licences restate this figure in relation to revocation of the licence to be a much higher figure. It may be that such values would also need review in this context to ensure that a failing supplier was captured by the processes.

If all the necessary steps were to be put in place, it is possible that the period from non-payment of an invoice to removal of the supplier's ability to incur further liabilities in the Pool could be reduced to about 25 days (without taking account of the licence revocation notice requirement) made up as follows:

- credit call and non-replacement of credit cover – 3 Working Days;
- delivery of “statutory demand” – one day;
- time allowed to pay “statutory demand” – 21 days;

In order that such a process could be effected, it would be necessary to make some changes to the TSC; firstly to oblige the Market Operator to serve the “statutory demand” on the Defaulting Participant

¹⁴ In outline Articles 103(1) and (2) provide that inability to pay debts can be determined by the High Court or if a court judgement is determined to be unenforceable or if a statutory demand for payment by a creditor remains unpaid after three weeks.

and secondly to ensure that even when a call on the Participant's credit cover has replaced the Shortfall or Unsecured Bad Debt, the debt is treated as only being discharged if the credit cover is replaced within the required timescale. The Regulatory Authorities are examining the changes that would be required to the TSC and are considering putting forward an Urgent Modification Proposal to given effect to such changes. The Regulatory Authorities would welcome comments on the possibility of making such changes and on the changes that might be proposed.

Ireland

In Ireland, the legal framework for the appointment of a Supplier of Last Resort by the Commission for Energy Regulation (the Commission) is set out in Regulation 21 of S.I. 60 of 2005¹⁵. The same S.I. defines the events that may trigger the transfer of customers to the SoLR:

“(2) The supplier of last resort shall supply electricity to final customers of another licensed supplier where –

- (a) a licensed supplier with whom final customers have a supply contract ceases or fails to supply electricity to those final customers in accordance with its contractual obligations; or
- (b) following representations to the Commission from a licensed supplier, the Commission is of the opinion that circumstances exist which warrant a direction to the supplier of last resort to supply electricity to a final customer.”

This provision 2(b) gives the Commission the power, subject to representation from a licensed supplier (in Ireland), if it so determines, to issue a direction to the Supplier of Last Resort to supply the final customers represented within a Supplier Unit which is the subject of a Suspension Order.

4. Supplier Suspension Delay Period

In concept, were full collateralisation of the market to be the aim, the Supplier Suspension Delay Period should be set as a period long enough to ensure that, if the relevant Regulatory Authority was to direct that a Supplier of Last Resort should be put in place in respect of the Supplier Unit or Units to which the suspension order relates, the wholesale market elements of such a direction could be put in place on or before by the expiry of the Supplier Suspension Delay Period. That is, that both the conditions necessary for the Suspension Order to have effect would be met by a particular point in time. Under these circumstances the Supplier Suspension Delay Period would have to be a period of at least 25 days (on the assumption that the licence revocation notice period in NI is reduced from the current level of 30 days) and even at that level full collateralisation of the market could not be ensured.

¹⁵ Statutory Instrument Number 60 of 2005 – ‘European Communities (Internal Market in Electricity) Regulations 2005.

The Supplier Suspension Delay Period is a driver of the level of credit cover in the market. However, it also needs to be long enough to allow for the following activities:

- a period of time to allow the Regulatory Authorities to determine the underlying driver of the Participant Default that has led to the Suspension Order; and
- a period of time to allow the Regulatory Authorities to consider and decide whether to instruct the Market Operator to amend the Suspension Order and/or whether a Supplier of Last Resort Direction might be called for at some point; and
- if possible, time for the defaulting Participant to find a solution to its financial problems.

The underlying circumstances that could give rise to the Market Operator issuing a Suspension Order in accordance with paragraph 2.243 of the TSC are potentially complex. If such a Suspension Order has been issued, then the Participant concerned has either failed to pay an invoice and a credit call has failed to deliver the necessary funds, or it has failed to provide the Required Credit Cover. The former circumstances are relatively unlikely given the TSC requirements for the form of credit cover set out in paragraph 6.162. The most likely circumstances are that a Participant fails to provide its Required Credit Cover. The suspension provisions are particularly aimed at the circumstances where, having been unable to pay an invoice and following a successful credit call, the Participant concerned is unable to make the necessary provision to replace its credit cover. These are circumstances where the Participant concerned is likely to be in serious financial difficulties and may, for example be seeking refinancing. Unless such efforts are successful, the Participant is likely to face financial failure rapidly. Under these circumstances the Regulatory Authorities would wish the Participant to be able to leave the market in a controlled fashion, without them having to make a Supplier of Last Resort Direction; that is to enable the Participant to sell its customer base, rather than having it removed.

The Regulatory Authorities note that the Supplier Suspension Delay Period could be interpreted as an option for a Participant to delay payment of its invoices for a period. However, the Regulatory Authorities note that under such circumstances, the Participant would not only be in Default under the TSC but also in breach of its licence condition to comply with the TSC. The Regulatory Authorities would regard such action by a licensee extremely seriously and would give urgent consideration to enforcement action under the licence.

The Regulatory Authorities take the view that 7 days is a sufficiently long period of time for the identification of the underlying drivers of the Default. In relation to any Suspension Order that the Market Operator proposes to issue in accordance with paragraph 2.246 of the TSC, the Regulatory Authorities note that they will be consulted before such an Order is issued and will therefore have more time to consider the necessary issues. In addition, given the complexity of the likely circumstances, the Regulatory Authorities believe that it is desirable to allow for a further period of 7 days during which the financial survival of a supplier in difficulties may be effected. Further, in an extreme case of supplier failure or abandonment of the Market, it should be possible to initiate a Supplier of Last Resort Direction within 14 days.

The Regulatory Authorities note that a Supplier Suspension Delay Period of 14 days would increase the total Required Credit Cover (if there were no Settlement Reallocation Agreements) by about €180 million, compared to the (infeasible) position of a Suspension Order which came into effect immediately. However, the Regulatory Authorities note that Settlement Reallocations are likely to be extensively used by market Participants to reduce their Required Credit Cover and that the cost of providing even €180 million of credit cover is unlikely to exceed €10 million pa which is less than ½% of the total market turnover. Further, the Regulatory Authorities note that a Supplier Suspension Delay Period of 14 days, would require all Participants to carry credit cover in respect of their Actual Exposure and a further two Billing Periods of invoices.

In addition, the Regulatory Authorities are conscious that the ability to manage the level of Required Credit Cover is most readily available (through the use of Settlement Reallocation Agreements) to a Participant in the market which has both Supplier Units and Generator Units registered. Such a Participant is unlikely to be a new entrant supplier and the Regulatory Authorities would not wish the level of Required Credit Cover to be a barrier to entry to such potential participants. Further, the Regulatory Authorities are conscious of the need strike a balance between the demands for credit cover on new entrant suppliers and the exposure of generators to the risk of bad debt.

The Regulatory Authorities therefore propose that the Supplier Suspension Delay Period should be 14 days and would welcome views on this proposal.

5. Generator Suspension Delay Period

The Regulatory Authorities note that the question of a Supplier of Last Resort Direction does not arise in relation to a Suspension Order in relation to a Generator Unit but believe it is right that the Participant should have the same opportunity to consult with the Regulatory Authorities before the Suspension Order comes into effect. They therefore propose that the Generator Suspension Delay Period should be 7 days.

6. Insurance

It has been suggested that insurance might be a more effective or cheaper means of dealing with the risk of failure by Pool debtors than the requirement to provide credit cover. The Regulatory Authorities take the view that the credit cover provisions are a secure and balanced means of setting an appropriate level of market collateralisation. The provisions have been developed following a lengthy consultation process. Further, Participants may use Settlement Reallocation Agreements to reduce the Required Credit Cover. Given the necessary uncertainty with regard to the action which the relevant Regulatory Authority may take in regard to a Supplier of Last Resort Direction, it is unlikely that commercial insurance would be available to cover the necessary risks at a cost lower than that which market Participants can achieve through the provision of the necessary credit cover.

The Regulatory Authorities do not propose any change to the TSC in respect of insurance provisions to replace the provisions in relation to Participants' Required Credit Cover.

7. Next Steps

The Regulatory Authorities welcome all comments on the proposals in this paper. The closing date for such comments is Friday 17th August 2007.

The Regulatory Authorities plan to publish their decision on the Supplier Suspension Delay Period and the Generator Suspension Delay Period early in September 2007.

Appendix 1

Supplier of Last Resort Processes

Following a Supplier of Last Resort Direction, action would need to be taken in respect of both the wholesale and the retail markets to give full effect to the Direction. The following section describes the present position with regard to the wholesale market processes for giving effect to such a Direction. It should be noted that all the parties concerned are continuing to develop both the wholesale and the retail market processes.

Wholesale Market Processes

Following discussions with the Distribution Network Operators, who maintain the retail records of Meter Point Registration Numbers (MPRNs) and the PES supply businesses in both jurisdictions, the Regulatory Authorities have determined that a Supplier of Last Resort (SoLR) Direction could currently be given effect in the wholesale market as follows:

- Northern Ireland Electricity Transmission and Distribution (NIE T&D) would continue to include the aggregated Supplier Units to which the Suspension Order relates, in the Indicative, Initial and Resettlement metered data aggregations sent to the Market Operator until both NIE T&D and the designated Supplier of Last Resort can facilitate the transfer of the affected customers;
- Electricity Supply Board (ESB) Networks would not aggregate the Supplier Units to which the Suspension Order relates and consequently would not send Indicative, Initial and Resettlement metered data aggregations to the Market Operator;
- Both NIE T&D and ESB Networks would start (over a period of several days) to transfer the MPRNs to a new Supplier Unit registered to the Supplier of Last Resort in the relevant jurisdiction, aggregating the data and sending it over to the Market Operator;
 - once the new SoLR Supplier Unit has all the metered data previously aggregated to the Supplier Units to which the Suspension Order relates, no further action is required; however
 - if the new Supplier Unit does not have all the metered data previously aggregated to the Supplier Units to which the Suspension Order relates, but the new SoLR Supplier Unit is registered to the Participant which is the registrant of the Error Supplier Unit in that jurisdiction, no further action is required because the missing metered data will be captured by the Error Supplier Unit;
 - if the new Supplier Unit does not have all the metered data previously aggregated to the Supplier Units to which the Suspension Order relates, and the new SoLR Supplier Unit is not registered to the Participant which is the registrant of the Error Supplier Unit in that jurisdiction, the Market Operator would, in the interim, have to undertake

manual calculations using metered data volumes provided by the Distribution Network Operators and debit the SoLR Supplier Unit and credit the Error Supplier Unit in the relevant jurisdiction with the same sum of money. Such a requirement may continue for a number of days in the wholesale market. Once the SoLR Supplier Unit contains all the necessary metered data, the manual adjustments will have to be reversed during Resettlement billing;

- alternatively, such adjustments may be effected, following data queries by the relevant participants through the query and resettlement processes under the TSC;
- the MPRN transfers will occur daily and be retrospective to the effective date of the SoLR Direction for ESB Networks; and
- will be processed in a bulk-transfer after a preparatory phase to the Supplier of Last Resort by NIE T&D.

On the basis of the above, it appears that ESB Networks and the Ireland Supplier of Last Resort can facilitate within 1 day of a SoLR Direction, the energy associated with a Supplier Unit subject to a Suspension Order, to be transferred (from the perspective of the financial elements of wholesale Settlement) to the Supplier of Last Resort. In Northern Ireland, both NIE T&D and the relevant Supplier of Last Resort would need time to prepare for the facilitation the MRPN bulk transfer process. This process cannot have retrospective effect from the bulk transfer taking place. From NIE T&D's perspective the preparation phase is estimated to take 10 days at most. As the Supplier of Last Resort is not designated in Northern Ireland, it cannot be confirmed at this time that this time is sufficient from the Supplier of Last Resort's perspective. It is assumed at this time, however, that with appropriate development work, that such a timeline is possible for the Supplier of Last Resort.