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Dear Nick,

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Ofgem's Provisional thinking on Urgent Modification Proposal P37 "To Provide for the Remedy of Past Errors in Energy Contract Volume Notifications and in Metered Volume Reallocation Notifications".

These comments are provided in response to the Panel's request, under BSC F2.6.10 (b), for the Authority's view as to whether the findings of the interim report are consistent with the Authority's provisional thinking on P37 "To Provide for the Remedy of Past Errors in Energy Contract Volume Notifications and in Metered Volume Reallocation Notifications". The following view is therefore without prejudice to the Authority's considerations after receipt of a final Modification Report on this Modification Proposal.

The Authority's view was sought in respect of two specific issues, namely the nature and composition of the decision-making tribunal and the form the error correction payment should take.

DECISION MAKING AUTHORITY

The original Modification Proposal P37 was framed such that the BSC Panel would assess claims of erroneous notification and would be the final arbiter on whether to accept or reject such claims. However, consultation responses following the first Modification Group meeting indicated a range of possibilities. One suggestion was that although the Panel would decide on these matters, there should be a right of appeal to Authority. Another suggestion was that, owing to the materiality and possible impact on market arrangements that may arise as a result of a decision on erroneous contract notification, the Authority should be the final arbiter.

It is the Authority's provisional thinking that, were the modification to be accepted as establishing the general principle (as opposed to retrospective modifications on a case by case basis), it would be more in line with the existing governance arrangements for the Panel (acting either in total or through a specialist committee) to have responsibility for the decisions on these matters in a similar way to trading disputes and manifest errors. However, in view of the greater degree of judgement in deciding whether criteria are satisfied, the material impact on all Parties through the Residual Cashflow Allocation and the unclear nature of the counter-party in an arbitration hearing, the Authority would be in favour of the insertion of a clause permitting appeals to the Authority, within a specified time. However, such appeals should only be permitted where it is claimed that there has been a procedural defect in the hearing process or where new information has come to light since the Panel's decision. If it were intended to extend the right of appeal to all Parties then specific clauses would need to be inserted.

FORM OF ERROR CORRECTION PAYMENT

The form and level of error correction payment were the subject of questions put to the parties in the consultation on P37. The Modification Group considered that three options could be contemplated. An error correction payment of:-

1. a percentage of the reimbursed energy charges with a cap;
2. a percentage of the reimbursed energy charges with no cap;
3. a percentage of the energy imbalance charge associated with the total claim whether or not the claim was successful.

The Authority has not heard any arguments to date, and as a result of the Modification Proposal P37 process, that alter the view contained within Paragraphs 25 and 37 of the Authority's decision letter on Modification Proposal P19 where the Authority stressed the importance of maintaining incentives to accurate notification while recognising that in some cases, losses may be disproportionate to the incentives necessary.

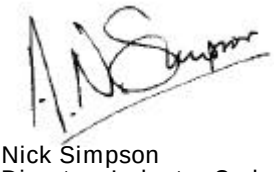
In the interest of maintaining incentives, paragraph 25 (ii) indicates that an error correction modification would not necessarily be incompatible with the BSC Objectives or the Authority's statutory duties if one of its elements included a fixed percentage limit on recovery of a claim in addition to a fee. The rationale behind setting the limit in terms of a percentage, that is, in relative terms as opposed to a fixed cap, was to ensure insofar as is possible, parity of treatment for well resourced and less well resourced participants who may intend to lodge claims for losses arising from erroneous contract notification. The possibility exists as

indicated in the last option for the recovery to be further limited where part of the claim is rejected, on the basis that this may reduce spurious claims. It is Ofgem's provisional thinking that a fixed percentage limit on recovery is applied with no possibility of a higher effective recovery for larger claims. Ofgem has no view at present on whether further measures should be taken to limit spurious claims.

In Paragraph 37 of the decision letter on Modification P19 the Authority considers a more stringent cap on the retrospective recovery of monies lost through errors in notification, rather than for prospective errors, to be fitting. However, a prospective modification has not been forthcoming.

The responses to the consultation of Modification Proposal P37 were broadly split between recommending rejection of the modification (and therefore an implied limit on recovery of nil%) and support of the proposal of a limit on recovery of 80%, albeit with some parties supporting higher values. The Authority currently thinks, in the light of the evidence and discussions to date and taking a view on the level of incentives that would have been necessary, that the value of 80% recovery may be too high, whereas recovery of no monies may be too low in the case of the necessarily exceptional circumstances.

Yours sincerely,



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