

DECISION ON THE CHANGE DISPUTE RECEIVED FROM SCOTTISH ELECTRICITY SETTLEMENTS LIMITED ON 14 APRIL 2003 AND THE PROPOSED INTRODUCTION OF TERMINATION FEES INTO SCHEDULE 8 OF THE DTSA.

1. Introduction

- 1.1. On 18 March the Data Transfer Service (DTS) User Group approved a change to the Data Transfer Service Agreement (DTSA) that would alter the Charging Principles, set out in Schedule 8 of the DTSA. This change would have the effect of removing the concept of a five year Minimum Connection Period for Users of the DTS, and replacing it with specified termination charges.
- 1.2. Clause 7.3.1 of the DTSA states that no change to Schedule 8 shall take effect without the prior consent of the Gas and Electricity Markets Authority (the Authority). On 20 April, Ofgem¹ received notification of the proposed Change from Electralink, the DTS Service Controller.
- 1.3. On 14 April a User of the DTS, Scottish Electricity Settlements Limited (SESL), referred a formal Change Dispute to the Authority in relation to this proposed change. This Change Dispute initially cited five grounds, although three were subsequently withdrawn by SESL on 12 May. Under Clause 7.5.1 of the DTSA a Change Dispute may be raised by any User of the DTS or the Service Controller at any time for determination by the Authority. Clause 7.5.3 states that, where a Change Dispute has been raised, the implementation of the Change Proposal in question must be suspended except in certain circumstances².
- 1.4. Ofgem, on behalf of the Authority, contacted all DTS Contract Managers and Electralink on 23 May, requesting views on the Change Dispute.

¹ Ofgem is the office of the Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

² These circumstances, set out in Clauses 7.3.7 and 7.4.9 relate to Changes raised by the Service Controller necessary to comply with obligations or requirements imposed by certain acts of legislation, licence conditions or industry agreements, and emergency Changes required to fix faults or errors to the DTS or reflect a change made to the Data Transfer Catalogue (DTC).

- 1.5. This document sets out a summary of the views expressed during this consultation, together with the Authority's determination on the Change Dispute and reasons for it.
- 1.6. In addition, this document also considers the Change Proposal itself and includes a decision on whether or not to grant consent to the proposed change to Schedule 8 of the DTSA.

2. Background

- 2.1. On 18 February, Electralink presented a paper to the User Group entitled DTS Pricing. This set out the new pricing structure for Users of the DTS to take into account the re-procured service from the current service provider Syntegra to EDS. Following discussion by the group, clarification on the required changes was sought and a further paper entitled DTS Connection Periods was presented to the User Group by Electralink on 18 March.
- 2.2. The paper asked the User Group to approve new termination charges. At present, Users that sign the DTS User Agreement commit to pay for the service for a minimum of 5 years – the ‘Minimum Connection Period’. There are no termination charges as such. This Minimum Connection Period is required by Schedule 8 of the DTSA – The Charging Principles – and therefore cannot be amended without the consent of the Authority.
- 2.3. The proposed termination charges are:

	Use of service terminated within:		
	0-6 months	7-36 months	37-60 months
High Volume Gateway (HVG)	£29,130	£14,565	N/A
Low Volume Gateway (LVG)	£19,760	£9,880	N/A
Remote User Site (RUS)	£1,650	£825	N/A

- 2.4. The fees would apply from 1 October 2003. Any User, even if they had completed their Minimum Connection Period under the Syntegra system, would be liable to pay termination fees if exiting the market within 3 years of this date.
- 2.5. At the User Group meeting on 18 March, the proposed change was approved by the majority of the group. SESL voted against the recommendation.

- 2.6. On 14 April, Ofgem received a Change Dispute raised by SESL in accordance with Clause 7.5.1 of the DTSA. This dispute cited five grounds, although three were withdrawn by letter on 12 May. The two remaining grounds were:
1. "The DTSA Change Process has not been followed by the manner in which this change has been issued and considered;" and
 2. "SESL's interests have been prejudiced as a result of the proposed change and the change is inequitable"
- 2.7. Following the approval of the Change Proposal in March, Electralink instructed their lawyers to draft the required revised wording to the DTSA. This legal text was submitted to the User Group for approval on 15 April and approved by majority. SESL abstained from the vote.
- 2.8. On 28 April, Ofgem received notification of the proposed Change for approval.
- 2.9. Ofgem contacted Contract Managers by e-mail on 23 May, setting out the process that would be followed for dealing with the Change Dispute and included copies of the Change Proposal, SESL's Change Dispute and subsequent letter withdrawing 3 grounds, and a copy of Ofgem's Procedure for Determining Disputes. The consultation process was made up of two stages. Firstly, views were requested on SESL's Change Dispute by 13 June. Following this, Contract Managers had until 27 June to comment on any of the views expressed by the respondents in this first stage. Ofgem stated in this letter that the Authority's decision on whether to grant consent to the Change Proposal would be made following the disputes process.
- 2.10. Ofgem received five responses, from Scottish Power, LE Group, British Gas, Electralink and WPD. On 16th June, copies of these responses were e-mailed to all Contract Managers. On 25th June the responses were put on the web-site.
- 2.11. Ofgem received one response (from SESL) in the second round of comments.

3. Points raised in relation to the Dispute

- 3.1. Ofgem received five responses in the first round of comments. None of these supported upholding SESL's dispute. One response, from SESL, was received in the second round.

Views on the process followed

- 3.2. SESL, in their dispute letter, expressed the view that the process followed for the proposed Change failed to meet the terms of the DTSA in three areas. First, no Change Request, as required by Clause 7.2, was ever raised. Second, the change was never circulated to Users for consideration in accordance with Clause 7.2.6. Finally, no impact analysis, required by Clause 7.3.2, was carried out upon which to base a decision.
- 3.3. Two respondents agreed with SESL's view that the correct process had not been followed for the proposed Change. However, these respondents felt that an opportunity was given for Contract Managers to view and comment on the proposed Change through circulation of User Group papers. They did not support upholding SESL's appeal on grounds of process.
- 3.4. The three other respondents did not express the view that the change process prescribed by the DTSA was followed incorrectly. Two respondents felt that the process of consultation followed by Electralink allowed ample opportunity for the impact of the change to be assessed. The third respondent believed that the points raised by SESL about the process followed were unfounded and that actions taken were consistent with the DTSA.
- 3.5. In the second round of responses, SESL expressed the view that the proposed Change was not circulated to all Users as required, but only to User Group representatives. In addition, SESL felt that, while the proposed Change had been issued to Users in advance of the April User Group meeting, the substantive decision on the proposed Change had already been made at the March meeting and that only the legal drafting was considered in April. They felt that the circulation of the proposed Change would therefore have been unable to bring about a material change to the proposal itself.

Views on prejudice to SESL's interests

- 3.6. SESL state in their dispute that the creation of termination fees would impose a fresh obligation to commit to the use of the DTS for a further three years. They believe that the new service provided by EDS will be for the continued benefit of all Users and therefore that it would be equitable for all Users to meet the liabilities that fall on a User that has fulfilled their existing 5-year obligation.
- 3.7. All 5 respondents to the consultation expressed the view that the proposed change would be a more equitable way of allocating the costs of termination than the current arrangements. It also was noted that the proposed termination charges would place less of an obligation on Users than the current Minimum Connection Period set out in paragraph A.4 of Schedule 8 of the DTSA.
- 3.8. One supplier stated that they believed they would pick up some of the costs of SESL exiting the market regardless of whether the termination fees were inserted into the DTSA. This is because the charges would either be passed on by SESL or be charged under Supplier Charges, as set out in Schedule 8 of the DTSA.
- 3.9. Another respondent pointed to uncertainty about the nature of the surviving settlement body after BETTA is implemented. They expressed the view that the two DTS gateways currently used by SESL and Elexon may be retained and, in which case, termination fees would not be payable. The respondent suggests that any termination fees that are charged should be added, by the Authority, to the costs of BETTA implementation.
- 3.10. Some respondents stated that any termination charges should be applied to all users of the service and that individual users should not be exempted from them.

4. Discussion and Decision on Dispute

Change process followed

- 4.1. Ofgem notes the view expressed by all respondents with the exception of SESL that, in their opinion, adequate consultation was carried out.
- 4.2. However, it is acknowledged in the responses from Users that the change process could have been more clearly defined. In particular, SESL have disputed whether the Change Control Notice, issued in April with the legal drafting, constitutes a Change Request under the requirements of Clause 7.2 as they considered that the principle of the Change had already been approved at the March meeting. Ofgem considers that SESL were able to express their views at both meetings on the merits of the Change. SESL also disputes whether a formal impact analysis was carried out within 10 working days of the Change Request being raised and circulated to all Contract Managers five working days before the User Group meeting, as required by Clause 7.3. Whilst the detail is ambiguous, it is clear the likely impact of the Change was reviewed with Electralink at the March and April DTS User meeting.
- 4.3. Ofgem agrees with the view expressed by some respondents that, due to the level of consultation that was carried out, it is not appropriate to revisit the change process on this occasion. However, Ofgem believes that the change process required by the DTSA should be clarified in future in order to prevent challenge on grounds of process.

Prejudice to SESL's interests

- 4.4. From the responses received, there are two separate issues to consider when determining whether SESL's interests would be unfairly prejudiced by the proposed change:
 - i) The change would be beneficial for the industry as a whole - All the responses received from, DTS Users (except SESL's) and Electralink state that the imposition of termination fees will be a fairer and more equitable way of dealing with termination. The Syntegra service chose to secure their initial cost of setting up the service from Users terminating early by obliging all

Users to pay for five years' use of the service (the Minimum Connection Period). If a User was not able to pay this charge, the cost would be picked up by all suppliers through DTS Supplier Charges.

The EDS termination fees only require payment if use of the service is terminated within three years. In SESL's case, it is most likely that they will be required to pay £14,565 for termination between six months and three years of introduction of the new system. SESL argues that existing users that have completed their Minimum Connection Period under the Syntegra system should not be liable to pay the EDS termination fees as this places an additional liability on them that was not visible when signing up to the service. They feel that the charges that are required by the EDS contract should instead be picked up by other users. It is Ofgem's view that, if this were to happen, newer entrants to the market that had not used the Syntegra system for five years would be required to pay for any older supplier withdrawing from the market. This would place an additional financial burden on new entrants.

It should however be noted that the industry has agreed to procure the DTS from a new service provider and that it will bring significant cost savings to all Users over the life of the 5 year contract. SESL themselves will benefit from these reduced costs for the amount of time they continue to use the DTS.

- ii) Any termination charges payable will be refunded from one of several sources - SESL is a not-for-profit organisation. There are a number of scenarios for payment of termination charges:
- Should SESL incur termination fees, the charges will be recovered from parties to the Settlement Agreement for Scotland (SAS) who fund SESL, ie. market participants in Scotland.
 - Should SESL, through this DTSA Change Dispute, not be required to pay termination charges, the costs will fall to electricity suppliers throughout Great Britain via DTS Supplier Charges.
 - SESL's exit from the market and resignation from the DTSA (if that proves to be the most cost efficient option) as a result of BETTA is by no means a

certainty. The way forward will emerge through consideration of these matters by the parties involved and, if appropriate, modifications being brought forward to the SAS. Should SESL incur the DTSA termination fee upon any exit from the market and SAS parties determine that the fee should not be recoverable through any ongoing Scottish Settlement charging, then the costs would ultimately fall upon the SESL shareholders (Scottish Power and Scottish and Southern). The SESL shareholders may seek to recover these costs through any BETTA cost recovery mechanisms. Recovery of any such costs will be subject to satisfaction of the relevant criteria set out in the BETTA cost recovery conclusions document³.

Determination of Dispute

- 4.5. Having regard to the points raised above, Ofgem determines that the Change Dispute raised by SESL on 14 April 2003 should not be upheld.

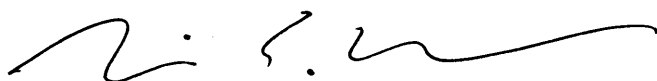
³ http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/3936_Costrecoveryresponse_conclusionsdoc.pdf

5. The Change Proposal

- 5.1. On 28 April 2003 Ofgem received a formal request from Electralink to grant consent to the Change Proposal detailed above. A copy of this Change Proposal can be found in Appendix 1.
- 5.2. Ofgem notes that this Change was approved by a majority of the DTS User Group. In addition, all respondents except SESL stated that termination fees are a suitable and equitable way of dealing with termination of use of the DTS.
- 5.3. Respondents to the consultation also noted that the cost of terminating use of the DTS would be much lower with the specified termination fees than at present under the Minimum Connection Period. In addition, the proposed termination fees would not be payable if terminating after more than three years of the EDS system implementation. This is in contrast to the five year obligation required by the Minimum Connection Period. Both these factors would place less of a financial burden on new entrants to the market and lower barriers for users to exit the market.

Decision

- 5.4. Ofgem agrees with the majority view that the introduction of termination fees as set out in the Change Proposal are a suitable and equitable way of dealing with termination of use of the DTS. Ofgem also agrees that the reduced cost of termination and reduced period over which these fees are payable places less of a financial burden on new entrants and lower barriers for users to exit the market.
- 5.5. It is therefore Ofgem's decision to consent to the implementation of this proposed Change to Schedule 8 of the DTSA, as contained in Appendix 1.



Iain Osborne

Authorised to sign on behalf of the Authority

3 October 2003

Appendix 1

CHANGES TO DTSA

SECTION 1 - INTERPRETATION

Clause 1.1 Definitions

In this Agreement, including the recitals and the Schedules, except where the context otherwise requires:

"Connection Date"

means:

(i) for Users that are Users as at 14 September 2003, the relevant date shall be 14 September 2003;

(ii) for all Parties that become or became Users after 14 September 2003, the relevant date shall be the date on which that Party completes their User Preconnection Acceptance Test to the satisfaction of the Service Controller

"Minimum Connection Period"

means in respect of a Gateway the minimum period of five years from the date of the successful completion of the User Preconnection Acceptance Tests for that Gateway, save in respect of an Unsupported Trading Station in which case the minimum period is 12 months from the date of the successful completion of the User Preconnection Acceptance Tests relating to that Unsupported Trading Station, or such other period as is specified in the Local User Agreement relating to such Unsupported Trading Station;

"Termination Charge"

means those charges for Gateways terminated within 6 months of the Connection Date or between 6 and 36 months, depending on whether a High Volume Gateway, a Low Volume Gateway or a Remote User Gateway is being terminated.

These charges are calculated in accordance with the Charging Principles requirement for User Charges specifically "Additional

Charges" and specified in the Schedule of Charges as published within the Data Transfer Handbook.

SECTION 8 - CHARGING

Clause 8.1

Each User agrees to pay all Charges incurred by it in relation to its connection to and termination of its use of the Data Transfer Network, in accordance with the Charging Principles.

SECTION 13 - TERMINATION

Clause 13.6

On termination of this Agreement in respect of a User pursuant to Clause 13 the Service Controller shall issue an invoice in respect of any outstanding Charges, and such invoice shall be payable in accordance with Clause 9. Such Charges shall include any Termination Charges relating to any Gateway ~~for the Minimum Connection Period.~~

SCHEDULE 8

CHARGING PRINCIPLES

In setting the level of any Charges the Service Controller shall have reference to the following principles:

A. User Charges

1. Each User will be charged :

- (i) Service Standing Charges relating to one or more Gateway Options that are provided to that User;
- (ii) Charges for Traffic and Local Traffic sent by that User;
- (iii) Charges for any Additional Services provided to that User from time to time; and
- (iv) an appropriate share of the Service Controller's administration costs.

Charges in categories (i) to (iii) above shall be calculated on the basis of Charges invoiced or to be invoiced by the Network Service Provider to the Service Controller. The Charges in category (iv), above, shall be calculated as a contribution to the Service Controller's costs for providing the Data Transfer Service.

2. The Service Standing Charges shall be invoiced quarterly in advance.
3. Traffic Charges will be calculated on the basis of the volume of Traffic and Local Traffic as measured on input to a User's Gateway in Kbytes, from the User's side of the Gateway, and shall be invoiced monthly in arrears.
4. ~~Save for the Remote User Service, Users will commit to paying the Service Standing Charges for a Minimum pay a Termination Charge on any Gateway terminated within 36 months of the Connection Period of 20 Quarters Date. The Remote User Service has a Minimum Connection Period rate of 4 Quarters Termination Charge payable in the event of premature termination of the DTSA is set out in the Schedule of Charges published within the Data Transfer Handbook. Other Gateway Options may have different Connection Periods The Users agree and acknowledge that these amounts are liquidated damages which represent a true and fair estimate of the probable cost to Electralink of early termination by a User of its participation in the DTSA.~~
5. Any Service Credits received by the Service Controller under its agreement with the Network Service Provider shall be credited against the total cost of the Service.

B. Supplier Charges

1. In addition to User Charges, Suppliers will also pay Supplier Charges that will enable the Service Controller to recover the costs of setting up and continuing to provide the Data Transfer Service.
2. Supplier Charges will be levied monthly in arrears based on the Unit Charge and the Units attributed to a Supplier in relation to the preceding month.

3. The total amount to be recovered from all Suppliers in any year will be the aggregate of:
- (i) any charges from the Network Service Provider to the Service Controller not recovered as a User Charge;
 - (ii) any operating costs of the Service Controller not recovered as a User Charge;
 - (iii) charges consistent with full recovery over a five year period of the costs of procuring and setting up the Data Transfer Service and an appropriate rate of return.

4. The total Charges across all Suppliers in any year of account will be calculated as:

$$SC = P_s + C_s + A_s$$

5. The calculation will follow the principles set out below:

$$P_s = P + P^1 - P_u$$

where:

P_s is the revenue to be recovered from Suppliers to cover Network Service Provider charges;

P is the total estimated charge from the Network Service Provider for the year of account;

P_u is the estimate of Network Service Provider charges to be recovered in total as Users Charges; and

P^1 is the adjustment necessary to reflect the difference between estimated and actual costs for previous years.

$$C_s = C + C^1 - C_u$$

where:

C_s is the revenue to be recovered from Suppliers to cover the costs of operating the Service Controller function;

C is the estimate of the total Service Controller operating costs for the year of account;

C^1 is any adjustment necessary to reflect the difference between estimated costs and actual costs for previous years; and

C_u is the estimate of Service Controller Charges to be recovered as User Charges.

A_s

where A_s is the capital recovery element including an appropriate rate of return on investment based on full recovery over a five year period of the costs of procuring and setting up the Data Transfer Service.

6. The Unit Charge for any year of account will be calculated as:

$$[SC/(\text{Service Controller's forecast of Total Units})] + K$$

where K adjusts for any error in estimating Total Units for previous years.

7. The above Charging Principles are based on the assumption that the Service Controller will amend the Charges on an annual basis to reflect a balance between revenues and costs.

Without prejudice to the Service Controller's ability to vary charges at any time under Clause 8.4 in accordance with the Charging Principles, following discussions with the Authority, the Service Controller will endeavour to maintain the Charges at consistent levels for periods of longer than one year. The Service Controller will keep the Charges under review with a view to achieving the investment recovery over a five year period.