

Modification Proposal – BSCP40/03

MP No: P248
(mandatory by BSCCo)

Title of Modification Proposal (mandatory by originator):

Aligning BSC requirements for further interest calculations with the FAA calculation method and P235 principles

Submission Date (mandatory by originator): 10 December 2009

Description of Proposed Modification (mandatory by originator)

The Authority approved Modification Proposal [P235](#) on 30 June 2009, with a retrospective Implementation Date of 27 March 2001 (NETA Go-Live).

P235 brought the BSC requirements for calculating interest on Reconciliation Charges¹ in line with the actual calculations which the Funds Administration Agent (FAA) has used since NETA Go-Live (and which mirror the methodology used under the Pool arrangements).

P235 did this by amending the BSC to clarify that interest on Reconciliation Charges ('reconciliation interest') should be calculated:

- Over the period from (and including) the Payment Date of the corresponding Initial Settlement Run, up to (but excluding) the Payment Date of the current Reconciliation Run;
- On a daily compound basis (i.e. the amount on which interest is calculated for each day in the above period includes the accumulated interest levied on previous days); and
- Using the applicable Base Rate for each day in the calculation period (thereby taking account of any changes in the Base Rate during this period).

The P235 Modification Group considered in detail the principles underlying the calculation of reconciliation interest. The Group concluded that:

- The calculation of interest should reflect the principle behind the BSC's Reconciliation process (that Reconciliation Charges should adjust BSC Parties' payments as if the 'correct' monies had been exchanged on the Payment Date of the Initial Settlement Run), and the time value of money to Parties;² and
- The actual FAA calculations more fairly and/or accurately reflected this principle.

¹ The BSC Settlement processes allow for prompt initial Settlement using demand estimates. This initial Settlement calculation, or Initial Settlement Run, is 'refreshed' via Reconciliation Runs which are subsequently made over a 14-month period as actual metered data becomes available. Reconciliation Charges are the adjustments made to a Party's Trading Charges following a Reconciliation Run. These adjustments are intended to make it as if the metered data determined at that Reconciliation Run had been submitted at the Initial Settlement Run.

² The 'time value' (sometimes called the 'earning value') of money means the principle that it is better to receive an amount of money today rather than an equal amount in the future, because of the interest that can be earned on it between now and then. So Parties who have overpaid at the Initial Settlement Run or subsequent runs should be compensated (through interest) for the loss of use of their money during the period of overpayment. Similarly, Parties who have initially underpaid should pay interest for the period of the underpayment, to reflect their ability to use money which they would not otherwise have had.

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This Modification Proposal seeks to bring the BSC's requirements for four further FAA interest calculations in line with the principles of accuracy and fairness established by the P235 Modification Group.

These calculations are for:

- 1) Interest on Ad-Hoc Trading Charges relating to Extra-Settlement Determinations (ESDs). In particular, Section U2.2.3(i) of the BSC requires interest to be calculated if an ESD is followed by a subsequent Settlement Run for the same Settlement Day;
- 2) Interest on payments relating to Contingency Provisions (i.e. Black Start, Manifest Errors, and Q8 compensation);
- 3) Interest relating to Initial Settlement Runs for which the Payment Date is delayed by more than a week; and
- 4) Interest relating to late payment of Trading Charges ('Payment Defaults').

The FAA's actual calculations are already consistent with the P235 principles. This Modification Proposal is therefore not expected to impact current processes. Rather it will, like P235, bring the BSC in line with established industry practice.

The Proposed Modification should have a retrospective Implementation Date of NETA Go-Live, for the same reasons as the Modification Group and the BSC Panel put forward for P235. These are that calculating interest on a compound basis has always been the intended and correct method, and that confirming this retrospectively would protect Parties from the risk and cost of calculations being challenged through the Trading Disputes process. The P235 Group and the Panel agreed that, while retrospective changes are normally to be avoided, in these specific circumstances retrospection would remove (rather than create) uncertainty.

Of the four types of interest calculation covered by this Modification Proposal, only that for interest on late payment of Trading Charges takes place with any frequency. Calculation of interest on Contingency Provisions is a relatively infrequent event. The calculations relating to Postponed Initial Settlement Runs and ESDs falling between two Settlement Runs have (to the best of ELEXON's knowledge) never been required.

Description of Issue or Defect that Modification Proposal Seeks to Address (mandatory by originator)

Although the identified calculations are varied in nature, they all arise as a result of Trading Charges being amended and/or paid after the Payment Date of the Initial Settlement Run. The principles agreed by the P235 Modification Group for interest on Reconciliation Charges should therefore also apply to these calculations.

However, the following two aspects of the current BSC requirements for these calculations do not reflect the P235 principles of fairness and/or accuracy:

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a) The BSC does not make it clear that interest should be calculated on a daily compound basis, using the interest rate applicable to each day.

This issue affects the:

- ESD provisions in U2.2.3(i);
- Contingency Provisions for Black Start in G3.3.6(a), Manifest Errors in Q7.6.5(a) and Outage Compensation in Q8.3.1(b);
- Postponed Initial Settlement Run provisions in N6.6.2; and
- Non-paying BSC Debtors provisions in N9.4.1.

The current BSC wording could be read as implying the use of 'simple interest'. This would mean that the amount on which interest is charged would remain the same for each day in the calculation period, ignoring any interest accumulated on previous days. The BSC could also be read as implying (although it is somewhat ambiguous) that a single Base Rate should be applied to the whole calculation period, ignoring any changes in the Base Rate during that period.

This would not accurately reflect the principle behind adjusting Trading Charges or the time value of money to BSC Parties.

b) The ESD provisions in U2.2.3(i) state that, where an ESD is followed by a subsequent Settlement Run for the same Settlement Day, interest should be calculated for the period from the Payment Date of the ESD "to the Payment Date in respect of such Settlement Run".

When interpreted in conjunction with X2.3.1 this implies that the period for which interest is calculated includes, rather than excludes, the Payment Date of the current Reconciliation Run.³

While the materiality of this issue is small, the BSC requirement represents an (albeit minimal) over-calculation of interest. This is because Parties have until the end of the Payment Date to make payment and any payment does not become overdue until the following day.

Impact on Code *(optional by originator)*

This Modification Proposal will impact the following sections of the BSC:

- ESD provisions in U2.2.3(i);
- Contingency Provisions for Black Start in G3.3.6(a), Manifest Errors in Q7.6.5(a) and Outage Compensation in Q8.3.1(b);
- Postponed Initial Settlement Run provisions in N6.6.2; and
- Non-paying BSC Debtors provisions in N9.4.1.

³ X2.3.1 says that where any period under the BSC is to run to a given day, such period shall run to the end of that day.

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*(mandatory by BSCCo)***Impact on Core Industry Documents or System Operator-Transmission Owner Code** *(optional by originator)*

No impact.

Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties *(optional by originator)*

Approving this Modification Proposal will have no impact on BSC Agents' or BSC Parties' systems and processes. This is because it will align the BSC with the calculations which the FAA already uses.

However, rejecting this Modification Proposal could result in costs to the FAA (and possibly to Parties) to align systems and processes with the BSC. It could also result in the risk and costs of calculations being challenged through the Trading Disputes process.

Impact on other Configurable Items *(optional by originator)*

Changes will also be needed to the FAA Service Description, which is based on the current BSC wording.

Justification for Proposed Modification with Reference to Applicable BSC Objectives *(mandatory by originator)*

The FAA method of calculating interest is fairer and/or more accurate than the method detailed in the BSC. To align the BSC with the actual method undertaken by the FAA will remove any confusion over how interest is calculated, and will provide clarity to participants. This will promote transparency and efficiency, thereby better facilitating **Applicable BSC Objective (d)**.

Urgency Recommended: No *(delete as appropriate) (optional by originator)***Justification for Urgency Recommendation** *(mandatory by originator if recommending progression as an Urgent Modification Proposal)*

N/A

Details of Proposer: BSC Panel*Name**Organisation* BSC Panel*Telephone Number**Email Address.*

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Details of Proposer's Representative:

Name

Organisation.

Telephone Number

Email address

Details of Representative's Alternate:

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Attachments: Yes (delete as appropriate) (mandatory by originator)

If Yes, Title and No. of Pages of Each Attachment:

Attachment A: Legal Text