

Modification proposal:	<b>Balancing and Settlement Code (BSC): Aligning BSC interest calculation requirements with the FAA calculation method and P235 principles (P248)</b>		
Decision:	The Authority <sup>1</sup> directs that this proposal be made <sup>2</sup>		
Target audience:	National Grid Electricity Transmission Plc (NGET), Parties to the BSC and other interested parties		
Date of publication:	5 February 2010	Implementation Date:	27 March 2001 (NETA Go Live date)

## Background to the modification proposal

Interest is paid and/or due on various trading charges for which BSC parties are responsible under the balancing and settlement arrangements set out in the BSC. Interest is paid to parties who overpay on the amount of charges they owe and interest is paid by parties who underpay on the amount of these charges. Interest is calculated by the Funds Administration Agent<sup>3</sup> (FAA) through its systems and the same method of calculation has been used since NETA Go Live (27 March 2001).

The Authority approved the alternative to BSC modification P235 in June 2009<sup>4</sup>. P235 sought to address the difference between the FAA's method of calculating interest on reconciliation charges and the way that the BSC describes how that interest should be calculated by aligning the BSC description with the FAA's method. The FAA's method reflects the following principles:

- Interest is 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<sup>5</sup> in line with normal commercial practice;
- Interest is calculated on a daily compound basis, i.e. every further day's interest is calculated on the accumulated interest from previous days; and
- Interest is calculated using the applicable Base Rate for each day of the calculation period, allowing changes to the Base Rate to be taken into account.

The above principles underline the importance of the 'time value'<sup>6</sup> of money when calculating interest. In approving P235 alternative, the Authority acknowledged that no BSC party had raised a Trading Dispute regarding the way that interest is calculated by the FAA and that parties accept that its method is accurate and fair. The Authority also agreed that retrospective implementation of P235 from the NETA Go Live date was appropriate as it would remove market uncertainty about which interest calculation method should apply and ensure that the risk of parties raising disputes (though minimal) would be removed altogether.

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

<sup>3</sup> The FAA is the central system agent responsible for managing parties' financial liabilities under the BSC.

<sup>4</sup> The P235 decision letter appears on the Elexon website: <http://www.elexon.co.uk/>

<sup>5</sup> There are five timetabled Reconciliation Runs altogether: Initial Settlement (SF), First Reconciliation (R1), Second Reconciliation (R2), Third Reconciliation (R3) and Final Reconciliation (RF).

<sup>6</sup> The 'time value' reflects that a party which overpays ought to be appropriately compensated (in interest) for loss of its use of money for the period over which interest accrues. Likewise, a party which underpays ought to pay an appropriate amount (in interest) for use of money it would not otherwise have had for the period over which interest accrues.

Elxon undertook, on behalf of the BSC Panel, to investigate whether other provisions in the BSC regarding calculation of interest were misaligned with the principles considered under P235. Elxon identified four further interest calculations which were ambiguous and open to uncertainty, namely:

- Interest on Ad Hoc trading charges relating to Extra-Settlement Determinations (Section U2.2.3 (i))
- Interest on payments relating to Contingency Provisions (Black Start (Section G3.3.6 (a)), Manifest Errors (Section Q7.6.5 (a)) and Outage Compensation (Section Q8.3.1 (b))
- Interest relating to Initial Settlement Runs where the payment date is delayed by more than a week (Section N6.6.2)
- Interest relating to late payment of trading charges (Section N9.4.1).

In all these cases, the BSC text implies that 'simple' and not 'compound' interest would be calculated using a single Base Rate for the whole period. In the case of interest on Ad Hoc trading charges, the relevant provision also implies that interest would be calculated up to (and including) the end of the payment date for the current Reconciliation Run, which is not in line with normal commercial practice.

### **The modification proposal**

The BSC Panel raised modification P248 in December 2009 to address these further perceived defects in the BSC text. The Panel raised P248 as a self-evident change. It considered that P248 would better meet BSC Applicable Objective (d) by removing further inconsistencies between the FAA's method of calculating interest on the relevant charges and the BSC descriptions of those interest calculations and removing the risk of parties disputing these interest calculations. This approach would promote efficiency in the implementation and administration of the balancing and settlement arrangements.

### **BSC Panel<sup>7</sup> recommendation**

The Panel unanimously recommended implementation of the modification proposal at its meeting on 14 January 2010 and considered that it better met Applicable Objective (d).

### **The Authority's decision**

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 14 January 2010. The Authority has considered and taken into account the responses to Elxon's<sup>8</sup> consultation which are attached to the FMR<sup>9</sup>. **The Authority has concluded that:**

- 1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the BSC<sup>10</sup>; and**
- 2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties<sup>11</sup>.**

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<sup>7</sup> The BSC Panel is established and constituted pursuant to and in accordance with Section B of the BSC.

<sup>8</sup> The role and powers, functions and responsibilities of Elxon are set out in Section C of the BSC.

<sup>9</sup> BSC modification proposals, modification reports and representations can be viewed on the Elxon website at [www.elxon.co.uk](http://www.elxon.co.uk)

<sup>10</sup> As set out in Standard Condition C3(3) of NGET's Transmission Licence, see: [http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=4151](http://epr.ofgem.gov.uk/document_fetch.php?documentid=4151)

## Reasons for the Authority's decision

We note that the Panel raised P248 as a self-evident change based on their view that the principles established in the Authority's decision on modification P235 also apply to these other interest calculations. We also note that the materiality of the changes proposed in P248 is low as interest is calculated infrequently for the relevant charges and the amount of interest that would be re-distributed across BSC parties if the proposal were to be rejected would be minimal.

### *Applicable Objective (d) - promoting efficiency in the implementation and administration of the balancing and settlement arrangements*

We agree with the Panel and consultation respondents that the P235 principles do apply to these other interest calculations. The current BSC text is open to interpretation and also does not reflect these principles. BSC parties generally accept that the FAA's method of calculating interest is appropriate, fair and accurate and that the text should align with the FAA's method and not the other way round.

The costs of aligning the FAA's method with the BSC text would be significant, especially where the text is unclear. This approach would also retain the risk (however minimal) that parties may raise Trading Disputes regarding interest calculations. We note that no party raised a Trading Dispute even after the issue became known to them when modification P235 was raised. We consider that it is more efficient to bring the BSC text into line with the FAA's method, thereby also removing any risk that parties raise Trading Disputes.

### *Retrospective implementation*

We note the views of the Panel and consultation respondents that P248 should be approved with a retrospective implementation date, the NETA Go Live date. As was the case with P235 alternative, we agree that, in the particular circumstances arising in P248, there are strong grounds for retrospective implementation. The risk that parties raise Trading Disputes would be removed entirely and they would have clarity, certainty and transparency about the calculation of interest for the relevant charges at least cost.

The Authority has, in the past, approved changes retrospectively in accordance with specified criteria, namely:

- a situation where the fault or error occasioning the loss was directly attributable to central arrangements;
- combinations of circumstances that could not have been reasonably foreseen; or
- where the possibility of a retrospective action had been clearly flagged to the participants in advance, allowing the detail and process of the change to be finalised with retrospective effect.

Since the issue of retrospective implementation had been flagged up to BSC parties when P235 was raised and no party chose to dispute how interest is calculated by the FAA, we consider that parties are supportive of retrospective implementation as being appropriate in the circumstances.

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<sup>11</sup>The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989.

For the above reasons, we are satisfied that the proposal does therefore better meet Applicable Objective (d).

We are also satisfied that implementation of the proposal is consistent with the Authority's principal objective and wider statutory duties.

### **Decision notice**

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority, hereby directs that modification proposal BSC P248: 'Aligning BSC interest calculation requirements with the FAA calculation method and P235 principles' be made in accordance with the implementation approach set out in the FMR, namely, retrospective implementation on 27 March 2001 (the NETA Go Live date).

**Mark Cox**  
**Associate Partner, Industry Codes and Licensing**

Signed on behalf of the Authority and authorised for that purpose.