

Modification P39 Second Assessment Consultation

Background

The BSC Panel, as recommended by the BSCCo, raised Modification Proposal P39 on the 20th September 2001. It proposes that changes are made to the payment procedure (section N8 of the Code) and the payment default procedure (section N9 of the Code) to remove inconsistencies between the Code and the operating procedures. At the meeting on the 18th October, the Panel agreed that P39 should be submitted to the Assessment Procedure and the Assessment Report be completed and presented to the Panel meeting on the 17th January 2002.

An industry consultation was carried out as part of the Definition Procedure. The consultation responses were included in the Definition Report, which was presented to the Panel on the 18th October 2001. This report can be obtained from the ELEXON website at the following link http://www.elexon.co.uk/ta/modifications/modsprops/P039/P39_Def_v10.pdf. At this meeting the Panel agreed with the Modification Group's recommendation that the proposal should be submitted to the Assessment Procedure for further analysis and consultation.

As part of the Assessment Procedure legal text was drafted and issued for industry consultation. Following the consultation, further legal and financial issues came to light. The Modification Group therefore agreed that additional assessment of the modification was required. At the Panel meeting on the 17th January 2002 the Panel agreed that the Assessment Procedure be extended by one month to allow these issues to be fully investigated.

The following sections record the discussions and conclusions of the Modification Group at their meeting on the 22nd January 2002:

P39 Legal and Financial Issues

1. Prescription of Payment Timescales

There are a number of steps for the Funds Administration Agent (FAA) to carry out on each Payment Date. Timings of these actions are defined in section N8 of the Code. Although it has been agreed that parties are unable to guarantee the specific time of day that payment transfers are carried out, there are different deadlines within the day depending on how payment is to be made. For example the deadline for payment to a Collection Bank is earlier than the deadline for payment to the BSC Bank. This is to allow the relevant Collection Bank adequate time to transfer the funds to the BSC Bank. It is therefore possible for the FAA to confirm whether or not payment has been made into each of the Collection Banks before Close of Banking Business, although payments direct to the BSC Bank can not be confirmed until later. The main issue with this section of the modification came from attempts to define Close of Banking Business.

The Modification Group agreed that a payment deadline of 16:00 hours should be specified in the Code as this is the latest time that payment can be made to the Collection Banks to allow it to be transferred to the BSC Bank on the same day. It is the responsibility of the relevant Party to ensure that payment is received by this time. The Modification Group noted that whilst a later time could be specified for the BSC Bank, introducing two separate deadlines would not aid clarity and therefore, the deadline should be the same for all Parties.

2. Payment Default Thresholds

The initial work undertaken by the Modification Group has focused on establishing a series of payment default thresholds with associated maximum timescales that would be used to determine when actions must be made. Additionally, discretion would be given to ELEXON to initiate earlier action.

The legal advisors have raised two main concerns. Firstly, they advised that discretion to enable ELEXON to shorten the periods used for the payment default thresholds is imprudent as this could leave ELEXON open to legal challenge. They also believed that, should this course of action be followed then, the relevant amounts and periods used for the payment default thresholds should be detailed in the Code, rather than the subsidiary documents. Specifying these within the Code differs from the Modification Group view and the responses received through the previous industry consultation.

In addition to the legal advice, a potential issue relating to VAT was identified. The current agreement with Customs and Excise, that payments under section N are Standard Rated for VAT purposes, is based on the existing provisions of the Code. Therefore it was observed that prior to any changes being, confirmation should be obtained that the current agreement will not be affected.

In light of this advice, the Modification Group agreed that the creation of payment default thresholds should not be included in this modification as, without the discretionary element, they could be simply seen as a reason for Parties to defer payment to a later date. It was agreed that ELEXON should instead ensure that Parties are making payments on time and that all late payments are treated in accordance with the Code, as currently drafted. Although this may increase the administration costs in the short term, it is envisaged that this approach will lead to a reduction in late payment and therefore save money in the long term. Furthermore it was felt that striving for compliance, and avoiding latitude, would better protect Parties collective interests in the case of a Defaulting Party.

3. Letters of Credit

The original modification raised the issue of the time taken to process Letters of Credit. It stated that the Code should include provisions for Letters of Credit to be called on the Payment Date (if payment hasn't been received) so that the funds are available on D+1.

Experience relating to the Enron Capital and Trade Resources Ltd default has shown that the time taken to receive funds following a Letter of Credit being called could be significantly longer than one Business Day. This is due to the International Chamber of Commerce Uniform Customs and Practice for Documentary Credits, which states that the issuing bank has a reasonable time to consider any claim. Therefore, in practise, funds may not be received for a week after the Letter of Credit is called.

The Modification Group agreed that the current D + 2 provision for a Party initially entering default should be retained, but that sections N9.2.1 and N9.2.2 should be modified to allow Credit Cover to be called on the affected date once a party is already in default (in accordance with section H of the Code). This proposal would minimise the use of the borrowing facility when a Party stops paying but continues to accumulate Trading Charges.

4. Payment transfers

The final area of change raised in the modification relates to the use of banks which do not have branches in the UK. The Modification Group initially suggested that an explicit

statement should be added to the Code stating that the BSCCo and their agents will not pay any bank charges for additional payment transfers.

The BSCCo's legal advisors believe that it is not necessary to include an explicit statement regarding foreign transfer charges in the Code as this is covered by the existing requirement to make payment in full to the BSC Clearer (section N6.7.1 of the Code). Parties must therefore arrange for the payment of any transfer charges separately. Legal advice is that the inclusion of an explicit statement regarding payment transfers might undermine the general requirement that payment in full is required.

In the absence of an explicit statement being inserted into the Code, the Modification Group agreed that ELEXON would issue a statement to ensure that all Parties are aware of the obligation to make full payment and that the BSCCo are not liable for foreign transfer charges. It was also suggested that this should be added to BSCP301.

Consultation

Following the Modification Group meeting the legal text has been revised and redlined copies are attached.

The Modification Group felt that these changes do not represent the introduction of an alternative modification, rather that they are an evolution of the original proposal based on the assessment that has been undertaken. This view is supported by legal advice.

Parties are requested to provide any comments that they may have on the legal drafting and confirm that they agree with the Modification Group's proposed way forward.

Please send your responses by close of business on Tuesday 5th February 2002 to the following e-mail address:

Modifications@elexon.co.uk

Please entitle your e-mail 'P39 Consultation/Assessment - 2'

Any queries or questions on the content of this consultation should be addressed to Sarah Parsons (sarah.parsons@elexon.co.uk) at ELEXON.