

Stage 04: Draft Modification Report

What stage is this document in the process?

- 01 Initial Written Assessment
- 02 Definition Procedure
- 03 Assessment Procedure
- 04 Report Phase

P235: Aligning BSC requirements with the calculation of interest performed by the Funds Administration Agent

P235 will align the Balancing and Settlement Code drafting for calculating the interest on Reconciliation Charges with the calculation methodology undertaken by the Funds Administration Agent systems. This methodology has been used by the FAA since NETA Go-Live, and mirrors that used under the Pool.



The Panel recommends:
Approval of the Alternative Modification with a retrospective Implementation Date of NETA Go-Live



Impact of approving P235: **Low**
P235 will align the Code with the calculation which the Funds Administration Agent already uses



Impact of rejecting P235: **High**
Rejection could result in system and process changes for the Funds Administration Agent and for BSC Parties

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About This Document:

This document is a Draft Modification Report, which ELEXON will present to the Panel on 11 June 2009. The Panel will consider the recommendations, and will agree its final view on whether or not this change should be made. ELEXON will then submit a Final Modification Report to the Authority.

This document contains a summary of the industry responses to the Report Phase Consultation. You can download the full individual responses from ELEXON's website [here](#).



Any questions?

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Why change?

There are inconsistencies between the Balancing and Settlement Code ('the Code') and the Funds Administration Agent (FAA) systems in calculating interest on Reconciliation Charges.

Solution and implementation

P235 will align the Code with the FAA systems calculation.

The Modification Group has developed a prospective (forward-looking) Proposed Modification and a retrospective Alternative Modification.

Impacts and costs

Approval of P235 has no impact on any systems or processes. However, rejection could result in changes to FAA/BSC Party systems and processes, to align these with the Code.

It will cost 3 man days' of ELEXON effort (£660) to implement this modification.

The case for change

Interest charges are fairer and/or more accurate for Parties under the FAA systems calculation than the Code provisions.

Recommendations

The Panel's initial unanimous recommendation is that the Alternative Modification should be made, with a retrospective Implementation Date of 27 March 2001 (NETA Go-Live).

This is in line with the unanimous view of the Modification Group and both Assessment and Report Phase Consultation respondents.



What are Reconciliation Charges?

The adjustments made to a Party's Trading Charges following a Reconciliation Run.

These adjustments are intended to make it as if the Metered Volumes determined at that Reconciliation Run had been submitted at the Initial Settlement Run.

Why has P235 been raised?

ELEXON has recently identified that the Code requirements for calculating the interest on Reconciliation Charges are inconsistent with the methodology used by the FAA systems. ELEXON notified the industry of the inconsistencies on 3 April 2009 in ELEXON Circular [01715](#).

Having analysed the effects of the differences between the FAA systems methodology and the Code requirements, ELEXON has concluded that the FAA interest methodology is the more appropriate calculation.

Following a recommendation by ELEXON, the Panel raised P235 on 9 April 2009 to align the Code requirements with the FAA systems and thereby remove the inconsistencies.

What inconsistencies are identified by P235?

The FAA systems have used the same method of interest calculations since NETA Go-Live, and mirror the methodology used under the Pool arrangements.¹ The Code requirements are detailed in **Section N6.4.2(b)**, and have remained unchanged in this respect since the Code was first drafted.

The FAA interest calculations differ from the Code requirements in four ways.

Area of inconsistency	FAA methodology	Code drafting
Start of interest calculation period	Interest calculation period extends all the way back to the Payment Date for the Initial Settlement Run	Interest is only calculated back to the Payment Date of the previous Reconciliation Run
Base Rate used in interest calculation	Calculates interest on a daily basis, using the Base Rate applicable to each day in the calculation period	Implies the use of a single Base Rate for each day in the calculation period
Accumulation of interest over the calculation period	Calculates interest on a compound basis (where the amount on which interest is calculated for each day in the period includes the accumulated interest levied on previous days)	Implies the use of simple interest (where the amount on which interest is charged remains the same for each day in the calculation period)
End of interest calculation period	Interest calculation period <u>excludes</u> the Payment Date for the current Reconciliation Run	Interest calculation period <u>includes</u> the Payment Date for the current Reconciliation Run

Section 2 in Attachment A explains the effect of the inconsistencies in more detail, and includes an illustration of their materiality for Parties' Trading Charges.

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¹ The New Electricity Trading Arrangements (NETA) replaced the previous Electricity Pool arrangements in 2001.



What is a Trading Dispute?

A mechanism for investigating a potential error in the data, processes or rules used for Settlement and (if appropriate) for recalculating impacted Trading Charges

P235 will amend Section N6.4 of the Code to align it with the FAA methodology.

The Modification Group has developed two solutions: a Proposed Modification and an Alternative Modification.

How are the Proposed and Alternative Modifications different?

The two solutions differ only in their implementation approaches.

The **Proposed Modification** would be implemented on a **prospective Calendar Day** basis, 2 Working Days after Authority approval.

This means that the Code would be aligned with the FAA interest calculation methodology for all Reconciliation Runs occurring on or after the Implementation Date. Parties would be able to raise Trading Disputes against the interest calculations for eligible historic Reconciliation Runs if they wished, as these would have been calculated in a manner which was inconsistent with the Code.

The **Alternative Modification** would be implemented **retrospectively** back to NETA Go-Live on 27 March 2001.

Under this approach it would be as if the inconsistencies between the FAA interest calculation and the Code had never occurred. If approved, Parties could not raise Trading Disputes against any interest calculations (past or future).

Section 4 in Attachment A provides further detail.

Where can I find a copy of the changes to the Code?

Attachments B and C contain the full amendments to the Code (the 'legal text') which would give effect to the Proposed Modification and the Alternative Modification.

This text has not changed from the versions which the Group provided in the Assessment Report.

You can find a detailed explanation of the legal text in Section 7 of Attachment A.



Where can I find more information on the implications of a Trading Dispute?

See Sections 2.6, 3 and 4 in Attachment A

Will P235 impact any systems and processes?

No, as approval of P235 will align the Code with the calculation method which the FAA already uses.

However, rejection of P235 could result in costs to the FAA and Parties to align systems and processes with the Code. The central costs of changing FAA systems are estimated at **£100k**. Several Parties have indicated that they would incur costs to amend their own systems which check the calculation of their Trading Charges. One of these Parties estimates these costs as being in the region of **£15k**.

Additionally, rejecting P235 would leave it open to Parties to raise Trading Disputes against historic interest charges (within the limits of the Section W Disputes process). This would incur costs to ELEXON, and potentially to Parties – the magnitude of which is unknown.

The only costs of implementing P235 will be **3 man days** of ELEXON effort (equating to £660) to update the Code and the FAA Service Description, which is based on the Code drafting. If P235 is approved, ELEXON will deliver the changes to the FAA Service Description as part of the next available BSC Release.



What is the Modification Group's view?

The Group believes that both the Proposed and Alternative Modifications are better than the Code drafting, but that the Alternative Modification is best overall

Why will P235 be better than the existing Code drafting?

The Modification Group unanimously believes that both the Proposed and Alternative Modifications better facilitate competition and thereby the achievement of **Applicable BSC Objective (c).²**

This is because both solutions:

- Better reflect the principle behind the BSC's Reconciliation process (i.e. 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;
- Give a fairer and/or more accurate result for Parties than the existing Code drafting; and
- Avoid costs to Parties in changing their systems and processes to align with the Code.

The Group also unanimously agrees that both the Proposed and Alternative Modifications better facilitate the achievement of efficiency and thereby **Applicable BSC Objective (d).³**

This is because they both:

- Reduce confusion;
- Promote clarity and transparency; and
- Avoid costs to align the FAA systems with the Code.

All industry respondents to the Group's Assessment Consultation agreed that both solutions better facilitate the achievement of the Applicable BSC Objectives when compared with the existing Code drafting.

You can find a more detailed explanation of these views in Attachment A.⁴

ELEXON has not identified any evidence that the BSC rules for calculating Reconciliation interest were intended to be different from the Pooling and Settlement Agreement. This suggests that the Code wording represents a drafting error and that the FAA calculation was the intended methodology for NETA.

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² Applicable BSC Objective (c) 'Promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity'.

³ Applicable BSC Objective (d) 'Promoting efficiency in the implementation and administration of the balancing and settlement arrangements'.

⁴ You can download copies of the full Assessment Consultation responses [here](#).

Why does the Group support a retrospective change?

The Group unanimously agrees that the Alternative Modification will better facilitate the achievement of **Applicable BSC Objectives (c) and (d)** when compared with the Proposed Modification.

This is because the Group notes that any Trading Dispute against interest calculations could, if upheld, change and redistribute Parties' past cash flows.

The Group believes that this poses a risk to Parties, as it:

- Creates uncertainty for Parties (with a negative effect on competition);
- Results in a less fair/accurate (and therefore anti-competitive) calculation of Parties' interest charged and/or received; and
- Has resource implications for ELEXON (reducing its efficiency in administering the BSC arrangements) and for Parties (who would have to reprocess invoices).

The Group believes that a retrospective implementation back to Go-Live is therefore appropriate and desirable in this specific case, because it gives absolute clarity and certainty that the methodology used since NETA was the intended and correct calculation.

The Group notes that the Alternative Modification is not a typical retrospective change, since it normalises the status quo and actually prevents alterations to Parties' historic cash flows.

Respondents to the Assessment Consultation unanimously supported these views.

Sections 4 and 5 in Attachment A provide a more detailed explanation of the Group's reasons for supporting the Alternative Modification.



What is the Panel's view as the Proposer of P235?

The Panel supports both the Proposed and Alternative Modifications, but believes the retrospective Alternative is best overall

What were the Panel's initial views?

The Panel considered the Group's Assessment Report at its meeting on 14 May 2009.

The Panel **unanimously** agreed with the Group and Assessment Consultation respondents that:

- Both the Proposed Modification and the Alternative Modification better facilitate the achievement of the Applicable BSC Objectives when compared with the existing Code drafting; and
- The Alternative Modification better facilitates the achievement of the Applicable BSC Objectives when compared with the Proposed Modification, because the Alternative retrospectively removes the inconsistencies between the Code and the FAA systems right back to the point at which they were first introduced (NETA Go-Live). The Alternative Modification thereby fully confirms the status quo.

The Panel's initial unanimous recommendation was therefore that the Alternative Modification should be approved.

In its views, the Panel relied primarily on the argument that P235 delivers benefits of increased clarity and transparency. The Panel believed that these benefits better facilitate **Applicable BSC Objective (d)**.

The Panel noted the arguments which the Group and Assessment Consultation respondents had made about benefits to Applicable BSC Objective (c). The Panel considered these arguments to be of second-order effect because they relate to implications and costs which would arise if P235 is rejected.

Implementation approach

In discussing the best implementation approach for P235, the Panel:

- Noted that the Alternative Modification's retrospective Implementation Date of 27 March 2001 has effect on a **Settlement Day** basis, because it applies to Reconciliation Runs for all Settlement Days occurring on or after NETA Go-Live (as distinct from the BSC's 'run off' arrangements for any Settlement Days which occurred under the Pool);
- Unanimously agreed that the Alternative Modification's retrospective implementation is more appropriate for the specific circumstances of P235 than the Proposed Modification's prospective (forward-looking) approach; and
- Unanimously agreed with the Group that if, however, the Proposed Modification is approved then a **Calendar Day** implementation is more appropriate for a prospective change than a Settlement Day approach.

Section 4 in Attachment A explains the difference between a Calendar Day and Settlement Day implementation in more detail.

Draft Legal text

The Panel unanimously agreed with the Group's recommended legal text.

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7 Report Phase Consultation Responses



What are consultation respondents' views?

Respondents unanimously recommend approval of the Alternative Modification, with a retrospective Implementation Date of NETA Go-Live

Following the initial Panel discussions ELEXON issued a Report Phase consultation. This consultation provides an opportunity for the industry to comment upon the Panel's initial recommendations.

This table summarises the Report Phase Consultation responses.

Question		Responses
1	Do you agree with the Panel's view that the Proposed Modification should be rejected ?	5 Yes - Unanimous 0 No
2	Do you agree with the Panel's view that the Alternative Modification should be approved ?	5 Yes - Unanimous 0 No
3	Do you agree with the Panel's suggested prospective Calendar Day Implementation Date for the Proposed Modification of 2 Working Days after an Authority decision?	5 Yes - Unanimous 0 No
4	Do you agree with the Panel's retrospective Implementation Date for the Alternative Modification of 27 March 2001 (NETA Go-Live)?	5 Yes - Unanimous 0 No
5	Do you agree that the legal text for the Proposed Modification and the Alternative Modification delivers the solutions agreed by the Modification Group?	5 Yes - Unanimous 0 No

The full responses are not contained as an attachment to this report. However, you can download the full individual responses [here](#).

Unanimous Industry Support

Respondents unanimously agree with the Panel initial recommendations that:

- both the Proposed and Alternative Modifications would better facilitate the achievement of the Applicable BSC Objectives; and
- the Alternative Modification, with a retrospective implementation date, is preferable.

No new arguments were raised by respondents.

Applicable Objective (c)

One respondent disagreed with the Panel view that the arguments against Applicable objective (c) were second order arguments.

The respondent explains that the status quo cannot be maintained. Either the BSC is amended or the FAA systems changed, depending on what the Authority decides. They therefore believe arguments under Objective (c) are not second order, as approving P235 would enforce the appropriate methodology and deliver the benefits of using that methodology, which are that the appropriate cashflows are not changed.

The respondent also notes that arguments under Objective (d) do relate to implications arising if P235 is rejected i.e. avoiding costs to align the FAA systems with the code. They question how it can be second order for Objective (c) and not for Objective (d).

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Recommendation

The Panel's initial unanimous recommendation is that the Alternative Modification should be made with a retrospective Implementation Date of NETA Go-Live

What are the Panel's final views?

This section will be completed following the Panel's meeting on 11 June 2009.

ELEXON invites the Panel to:

- NOTE the P235 Draft Modification Report and the Report Phase consultation responses;
- CONFIRM the recommendation to the Authority contained in the P235 Draft Modification Report that Proposed Modification P235 **should not** be made;
- CONFIRM the recommendation to the Authority contained in the P235 Draft Modification Report that Alternative Modification P235 **should** be made;
- AGREE a **prospective Calendar Day** Implementation Date for Proposed Modification P235 of 2 Working Days after an Authority decision;
- AGREE a **retrospective** Implementation Date for Alternative Modification P235 of 27 March 2001 (NETA Go-Live);
- AGREE the legal text for Proposed Modification P235 (as contained in Attachment B);
- AGREE the legal text for Alternative Modification P235 (as contained in Attachment C); and
- AGREE the P235 Modification Report or INSTRUCT the Modification Secretary to make such changes to the report as may be specified by the Panel.

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9 Further Information

You can find more information in:

Attachment A: Detailed Assessment

This attachment is Part 2 of the Modification Group's Assessment Report, and provides full details of the Group's assessment of P235 including:

- The Group's discussions of the areas set by the Panel in its Terms of Reference;
- A more detailed explanation of the differences between the Code drafting and the FAA methodology (with worked examples and information on the materiality to Parties);
- The effects and appropriateness of the different implementation approaches considered by the Group;
- The Group's views against the Applicable BSC Objectives (including its consideration of the industry responses to the Assessment Procedure consultation); and
- The Group's membership.

Attachment B: Proposed Modification Draft Legal Text

Attachment C: Alternative Modification Draft Legal Text

See these attachments for copies of the draft legal text as initially recommended by the Panel.

You can download further P235 documents, including the full industry responses to the Assessment Consultation and the Report Phase Consultation, from ELEXON's website [here](#).

Stage 03: Attachment A – Detailed Assessment for P235

P235: Aligning BSC requirements with the calculation of reconciliation interest performed by the Funds Administration Agent

What stage is this document in the process?

- 01 Initial Written Assessment
- 02 Definition Procedure
- 03 Assessment Procedure
- 04 Report Phase

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About This Document:

This is Part 2 (Attachment A) of the P235 Assessment Report.

This document explains how the Group's discussions led it to its chosen solution and its recommendations to the Panel. It also includes a summary of the industry responses received to the Group's consultation.

You can download copies of the full industry consultation responses [here](#).

1 Group's Terms of Reference



Who is the SSMG?

A standing group of industry experts, appointed by the Panel to consider potential Code changes in a number of subject areas – including Settlement invoicing and payment

The P235 Modification Group consists of members of the Settlement Standing Modification Group (SSMG).¹ Section 8 contains full details of the Group's membership.

Table 1 shows the areas which the Group has considered in accordance with its Terms of Reference, and where in this document you can find its discussions of each area.

Table 1 – P235 Assessment Procedure Terms of Reference

Area of Terms of Reference	Group's conclusion	See:
The appropriateness of the P235 solution in addressing each of the four identified inconsistencies in the calculation of Reconciliation interest, and the implications of not aligning the Code with the FAA methodology in these areas	P235 is the appropriate method to address the four identified inconsistencies	Sections 2 & 3
ELEXON's suggestion that P235 should be implemented on a prospective Settlement Day basis	It is more appropriate for any prospective implementation to occur on a Calendar Day basis – this is the Group's Proposed Modification	Section 4
Whether the particular circumstances of P235 warrant a retrospective Implementation Date, and whether this could form an Alternative Modification	In this particular case, it is desirable to implement P235 retrospectively all the way back to NETA Go-Live – this is the Group's Alternative Modification	Section 4
Whether the Proposed Modification would better facilitate the achievement of the Applicable BSC Objectives when compared with the existing Code drafting	The Proposed Modification would better facilitate the Applicable BSC Objectives	Section 5
Whether any Alternative Modification would better facilitate the achievement of the Applicable BSC Objectives when compared with the existing Code drafting and the Proposed Modification	The Alternative Modification would best facilitate the Applicable BSC Objectives overall	Section 5
Whether any amendments are required to ELEXON's suggested legal drafting in order to reflect the Group's solution	Minor changes made to reflect the implementation approach and two points of clarity regarding the application of the Base Rate	Section 7

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Detailed Assessment

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¹ The Group has been unable to obtain volunteers with relevant treasury experience to supplement its core membership, due to a low level of industry interest in participating in the Group.



BSC Section N6.1.5

Contains the principle that Trading Charges for any Reconciliation Settlement Run:

"are to be determined as though it were the first Settlement Run to be carried out in relation to the relevant Settlement Day, and so disregarding any payments which may on any prior Payment Date have been paid or payable in respect of the relevant Settlement Day"

2.1 Principle of Reconciliation interest

The 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. At each Reconciliation Run the Settlement calculation is re-run as though it were the Initial Settlement Run for the relevant Settlement Day, with more accurate metered data having displaced earlier estimates.

The key principle behind Reconciliation Charges (see Section N6.1.5 of the Code) is that they should adjust Parties' payments as if the 'correct' monies had been exchanged on the Payment Date of the Initial Settlement Run. The Group agrees with ELEXON and the Panel that this principle should also apply to the interest on Reconciliation Charges, due to the extended nature of the Reconciliation timetable and the time value of money.²

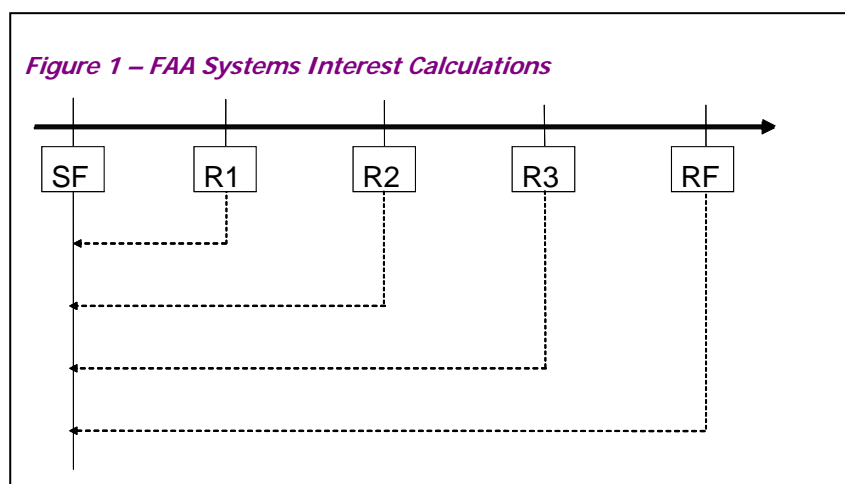
The Group considers that Parties who have overpaid at the Initial Settlement Run or subsequent runs should be compensated (through interest) for the loss of use of their money during the period of overpayment. Similarly, Parties who have initially underpaid should pay interest for the period of the underpayment, to reflect their ability to use money which they would not otherwise have had.

The Group agrees that the existing FAA interest calculation is the appropriate methodology to achieve this principle, and that it is therefore preferable to the Code drafting.

Sections 2.2-2.5 explain the Group's views on each of the four specific inconsistencies between the Code and FAA methodology. Section 2.6 outlines the potential materiality of the inconsistencies for Parties' Trading Charges. Section 3 describes the implications for Parties and the FAA if P235 was rejected.

2.2 Start of interest calculation period

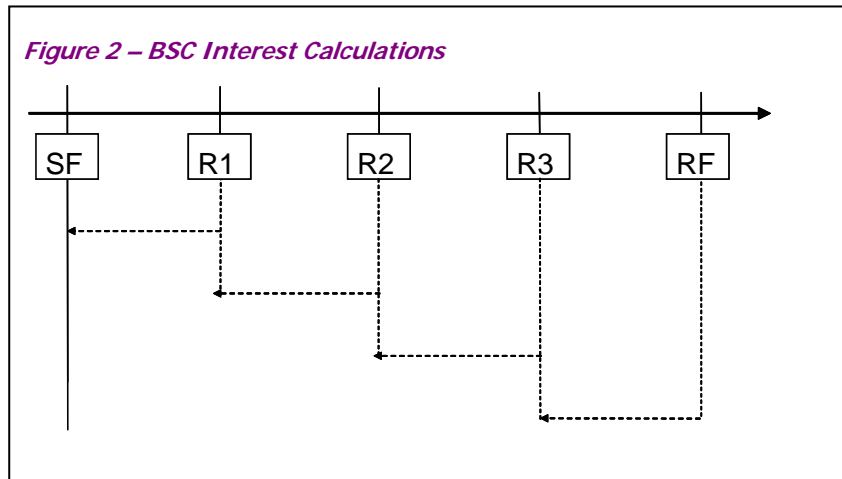
The **FAA systems** calculate interest back to the Payment Date of the Initial Settlement Run (see Figure 1). The interest on the difference between successive Trading Charge amounts is thereby always calculated with reference to the Payment Date of the Initial Settlement Run.



² The 'time 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.

The Group agrees that the FAA methodology is consistent with the principle of a Reconciliation Settlement Run, as the amounts are calculated as though they had been determined at the Initial Settlement Run.

The **Code drafting** explicitly requires interest to be calculated only as far back as the Payment Date of the previous Settlement Run (see Figure 2). This approach means that interest payments, rather than being referenced to a common point (the Payment Date for the Initial Settlement Run), are referenced only to the last Payment Date (which is a function of the Settlement timetable).



Under the Code drafting, Parties who had underpaid at the Initial Settlement Run and subsequent runs up to Final Reconciliation, and who then paid the correct amount at the Final Reconciliation Run, would only be charged interest back to the previous Settlement Run and not for the entire period of underpayment. Similarly, Parties who had overpaid at the first run and all subsequent runs up to Final Reconciliation, would only be compensated back to the previous Settlement Run. This would place those Parties who had initially overpaid at a disadvantage, since they would have been denied use of their money ever since the Initial Settlement Run.

The Group agrees that the Code drafting is contrary to the principle that Reconciliation should be undertaken as if it were the Initial Settlement Run.

Worked Example 1 illustrates this further on the following page.

In addition, the Group notes that the Code approach contains the opportunity for Parties to game, by systematically submitting lower consumption volumes up to Final Reconciliation. This risk of gaming is substantially reduced under the FAA methodology, since it always calculates interest back to the Initial Settlement Run.

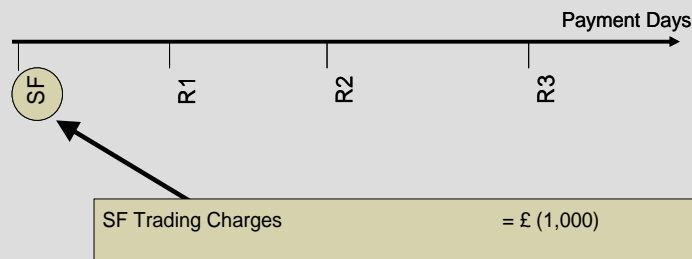
Worked Example 1 – Calculation back to the last Reconciliation Run or the Initial Settlement Run

The key principle of a Reconciliation Run is that it should adjust Parties' payments as if the 'correct' monies had been exchanged on the Payment Date of the Initial Settlement Run. This example shows why the FAA methodology is consistent with this principle.

1) Initial Settlement (SF)

At the Initial Settlement Run, the Trading Charges amount is calculated to be **-£1,000**.

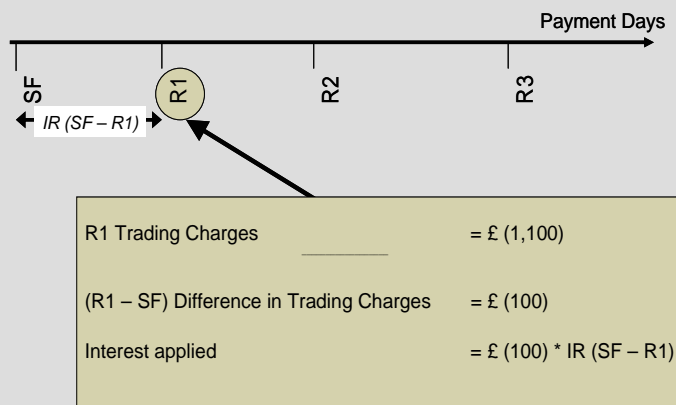
- A payment of **£1,000** would be made.



2) 1st Reconciliation (R1)

At the 1st Reconciliation Run, the Trading Charges amount is recalculated to be **-£1,100**.

- The difference in charges between the R1 and SF runs is **-£100**.
- Interest is applied to this difference. Under both the BSC and the FAA calculation interest would be applied back to the SF Run.
- The Reconciliation Charge is obtained by adding the difference and the interest amount (i.e. the two bullets above).



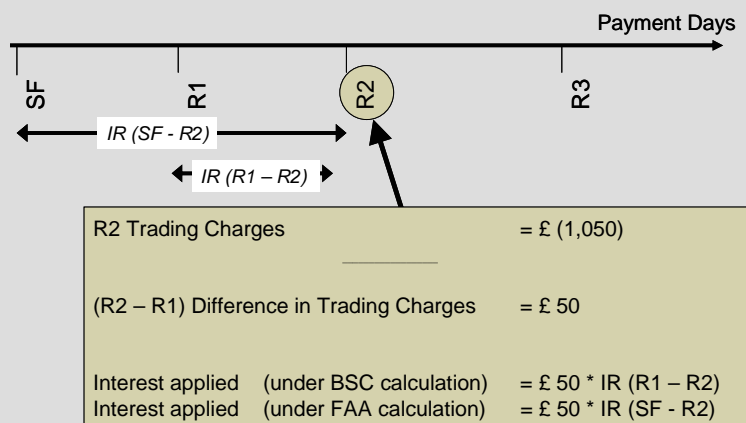
Applying this interest on the difference has the same effect as if £1,100 had been paid when the Initial Settlement Run was undertaken.

This occurs in both the FAA calculation and the Code calculation (albeit under the Code calculation a simple single interest rate is applied, whereas a daily compound interest rate is applied by the FAA systems).

3) 2nd Reconciliation (R2)

At the 2nd Reconciliation Run, the Trading Charges amount is recalculated to be **-£1,050**.

- The difference in charges between the R2 and R1 runs is **£50**.
- Interest is applied to the difference:
 - a) Under the Code, interest would be applied only back to R1
 - b) Under the FAA calculation, interest would be applied fully back to SF.
- The Reconciliation Charge is again obtained by adding the difference and the interest amounts. However, in this case the interest amounts differ dependent on how the interest is calculated.



Applying the interest back to the Initial Settlement Run (i.e. as per the FAA calculation) has the same effect as if £1,050 had been paid when the Initial Settlement Run was undertaken.

Applying the interest back only to the 1st Reconciliation Run (i.e. as per the Code calculation) fails to recognise that, if the 2nd Reconciliation Run data had been available when the Initial Settlement Run was conducted, then £1,050 should have been paid at the Initial Settlement Run. The calculation does not recognise that the £50 difference applies back to the Initial Settlement Run and not just the First Reconciliation Run. The lost “time value of money” amounts to $£50 * IR (SF - R1)$.

If the Party had made an overpayment at the 1st Reconciliation Run, then this effect would amount to a loss in the real time value of its money. Similarly, if the Party had made an underpayment at that run, this effect would have given them an inadvertent benefit. In each case, equal and opposite effects will be imposed on other Parties as the monies must still sum to zero overall.

Applying the FAA calculation and always establishing the monies as if they had been established at the Initial Settlement Run:

- **Negates the benefits/disadvantages that would arise from variations in Parties’ positions that are identified between Reconciliation Runs; and**
- **Is consistent with the overarching principle of a Reconciliation Settlement Run.**

2.3 Base Rate used in the interest calculation

The **FAA systems** calculate interest on a daily basis using the Base Rate applicable to each day in the interest calculation period.

In contrast, the **Code drafting** implies (although it is arguably somewhat ambiguous on this issue) that a single Base Rate should be applied to the whole calculation period, and that this should be the prevailing Base Rate on the day of the Advice Note for the current run.

The Group agrees that the FAA methodology is consistent with the principle behind Reconciliation interest (to reflect Parties' loss or use of money which they would not otherwise have paid or received). It agrees that the Code drafting fails to reflect the time value of money and results in a less fair outcome for Parties.

For example, if the Base Rate used at Final Reconciliation was appreciably lower than that at the Initial Settlement Run (as in the current economic climate), the interest payment under the Code rules would not adequately compensate Parties for the loss of use of their money over the extended Reconciliation period.

The recent dramatic cuts in Base Rate well illustrate the limitations of the Code approach, as shown in Worked Example 2 on the following page.

The Group also agrees that the FAA's methodology is more consistent with normal commercial practice than that presented in the Code.

For example, banks calculating the interest on a standard savings account take account of any change in their interest rates during the relevant period.

2.4 Accumulation of interest over the calculation period

The **FAA systems** calculate interest on a compound basis (i.e. the amount on which interest is calculated, the principal, increases each day in line with the interest rate).

However, the **Code drafting** implies the use of simple interest (i.e. the amount on which interest is charged would remain the same for each day in the calculation period).

The Group agrees that the FAA methodology delivers the most accurate way of reflecting the time value of money, and therefore delivers a fairer outcome for Parties than the Code drafting.

Worked Example 2 illustrates this further.

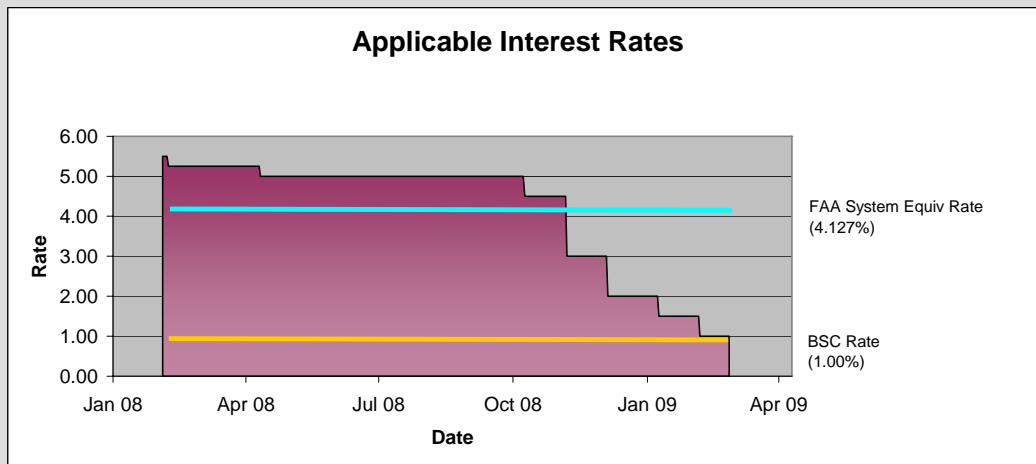
Worked Example 2 – ‘Simple single’ or ‘daily compound’ Base Rate

This example shows the difference between using a simple single interest rate (as the Code drafting currently implies) and a daily compound rate (as the FAA systems currently calculate).

To illustrate the effect, the examples uses data relating to the Final Reconciliation Settlement Run for Settlement Day 6 January 2008. Across this period there were 8 different Base Rates, ranging from **5.50%** to **1.00%**.

Settlement Date	06-Jan-2008	BSC Party	Example Company
Settlement Code	RF		
Calendar Payment Date	27-Feb-2009		

Start Date	End Date	No of Days	Principal	Interest Rate	Interest Amount	Total Including Interest
04-Feb-2008	07-Feb-2008	4	(1,000.0000)	5.50	(0.6029)	(1,000.6029)
08-Feb-2008	10-Apr-2008	63	(1,000.6029)	5.25	(9.1077)	(1,009.7105)
11-Apr-2008	08-Oct-2008	181	(1,009.7105)	5.00	(25.3465)	(1,035.0570)
09-Oct-2008	06-Nov-2008	29	(1,035.0570)	4.50	(3.7071)	(1,038.7641)
07-Nov-2008	04-Dec-2008	28	(1,038.7641)	3.00	(2.3932)	(1,041.1573)
05-Dec-2008	08-Jan-2009	35	(1,041.1573)	2.00	(1.9986)	(1,043.1559)
09-Jan-2009	05-Feb-2009	28	(1,043.1559)	1.50	(1.2010)	(1,044.3569)
06-Feb-2009	26-Feb-2009	21	(1,044.3569)	1.00	(0.6010)	(1,044.9580)
				Total Interest	(44.9580)	



- Using the simple single interest rate, interest would be applied at **1.00%** (i.e. the Base Rate in place on the Advice Note date, in this case 24 February 2009).
- Using the daily compound rate, the equivalent interest rate for the period would be **4.127%**.

In the example, the principal to which the interest is applied is £1,000.00. Using a simple single interest rate, the total interest would be £10.6575. Using the daily compound rate, the total interest due is £44.9580.

Whilst the movement in interest rates may have been pronounced across this period, this example shows that across the 14-month period the FAA System calculation more fully reflects the interest rates experienced by Parties and hence the value of money.

Note: The tabulated data mirrors the manner in which the calculation is presented in the Advice Note Backing Sheets. The Backing Sheets clearly show the differing Base Rates and the period for which they apply. The interest that has been applied is also clearly shown.

2.5 End of interest calculation period

The period for which the **FAA systems** calculate interest excludes the Payment Date of the current Reconciliation.

However, the **Code drafting** explicitly requires this to be included in the calculation period.

The Code requirements could be seen as an (albeit minimal) over-calculation of interest, given that Parties have until the end of the Payment Date to make payment and any payment does not become overdue until the following day.

The Group agrees that, while the difference between the two approaches is not significantly material, the FAA methodology is more consistent with normal commercial practice, and gives a fairer result to Parties than the Code drafting.

2.6 Materiality for Parties' Trading Charges

The Group notes that P235 intends to normalise the existing position regarding the calculation of Reconciliation interest, by aligning the Code with the actual FAA methodology. The Group agrees that this is appropriate, as the existing FAA methodology delivers a fairer and/or more accurate interest calculation for Parties. Implementation of P235 could be considered to have a financially neutral effect on Parties, in that it maintains the status quo and would not of itself reopen past interest calculations (avoiding the uncertainty to Parties of whether they might be liable for additional payments).

However, the Group notes that there will be 'winners and losers' on either side when contemplating differences between the Code and FAA interest rules.

The Group notes that the extent to which a Party's Reconciliation interest would be different under the Code rules would depend on how much its Trading Charges vary between Settlement Runs. Parties who establish their physical position quickly in the Reconciliation timetable (typically generators and Half Hourly Suppliers with accurate and correct metering) would be unlikely to see a significant effect. The difference could be greater for Non Half Hourly Suppliers, who replace estimated data with actual Meter readings towards Final Reconciliation. These Suppliers are also subject to the effect of Grid Supply Point Group Correction Factor on their Trading Charges.

ELEXON's analysis of the materiality to Parties

ELEXON has undertaken a comparison of the actual interest on Trading Charges (as calculated by the FAA) with those which would have resulted under the Code calculation. The period for comparison comprised all Reconciliation Runs³ for Settlement Days 1 November 2005 to 31 October 2006. The analysis provides an indicative materiality of the difference between the two sets of rules.

Trading Charges amounting to approximately £500m were paid or received by Parties over this period. These charges were levied across 123 Party IDs. The absolute⁴ difference between the FAA-derived interest charges and the Code equivalent for the period is approximately £1m (0.2% of the total Trading Charges).

³ Initial Settlement Run to the Post Final Settlement Run.

⁴ I.e. netting across Settlement Runs and Settlement Days for individual Parties, but ignoring netting between Parties.

Table 2 shows the distributional effect of the difference on Parties. The majority would only see a fractional shift in their interest payments, although a small number of Parties would be more significantly impacted.

Table 2 – Distribution of % impact between Parties

Absolute impact as % of payments at Post Final Reconciliation Run	Affected Parties
Less than 0.10%	109
0.10% to 0.49%	7
0.50% to 1.49%	5
1.50% to 2.99%	2
3.00% or more	0
Total	123

Interaction with Trading Disputes process

The Group notes that the inconsistencies between the interest calculations performed by the FAA and the Code provisions could be considered to be a Settlement Error under the Trading Disputes process.

The Group supports ELEXON's decision not to raise a Trading Dispute at this time, given that ELEXON believes the FAA methodology is preferable to the Code and is progressing P235. However, the Group notes that this does not prevent Parties from raising Disputes themselves. Any Dispute would open the possibility that historic calculations might need to be re-run and that Parties' payments might be retrospectively amended.

The Group notes that the raising of a Trading Dispute would not automatically result in the recalculation of past charges. The decision whether to uphold a Dispute would be taken by the Trading Disputes Committee (in accordance with the Trading Query/Dispute process in Section W of the Code), and is therefore outside the scope of P235.

A Party's ability to raise a Dispute would be affected by:

- The materiality threshold for raising a Trading Query (set at £500 in Balancing and Settlement Procedure 11 'Trading Queries and Trading Disputes');
- The time window set out in Section W of the Code for raising a Trading Query (which under normal circumstances is within 20 Working Days of the Settlement Run in respect of which the Settlement Error occurred);
- The TDC's judgement on whether a Settlement Error had occurred;
- Whether other Affected Parties challenged the outcome of the Trading Dispute;
- The time limit on rectifying any Settlement Error (since, even in exceptional circumstances, the Code does not allow errors to be rectified further back than 20 months for runs up to Final Reconciliation, or 29 months if the error occurred in a Post-Final Reconciliation Run – so a Party would not be able to dispute all calculations back to NETA Go-Live); and
- The TDC's judgement on whether the cost associated with re-running past interest calculations would outweigh the materiality of the Trading Dispute.

The Group notes that ELEXON has brought the inconsistencies between the FAA methodology and the Code to the industry's attention (through ELEXON Circulars, Newscast and the Panel/TDC), but that no Party has raised a Trading Dispute to date.

The Group also notes that the FAA methodology has been used since NETA Go-Live without being disputed by any Party, and that the methodology mirrors that used under the Pool.

ELEXON has investigated the discussions at the time of the Code drafting, and has not identified any evidence that the Code rules were intended to be different from the Pooling and Settlement Agreement. The interest calculation methodology contained in the Requirement Specifications which were used to build the FAA systems match that which has been used for the last eight years. The reasonable assumption of Parties therefore appears to have been that the Pool methodology would continue under NETA. This may explain the lack of any Dispute, as those Parties who have built their own systems to check the calculation of their Trading Charges are likely to have built them to the same Requirement Specifications as the FAA systems.

Given the timing restrictions on raising and rectifying Disputes, the materiality of those past interest calculations which Parties are able to challenge will not necessarily match that shown in Table 2. Additionally, a Party is unlikely to be consistently a 'winner' or 'loser' in each affected Settlement Period, and the net materiality across runs may not be significant.

The Group initially raised concerns that Parties might be able to 'cherry pick' which historic interest charges to dispute, such that they only challenge those where they stand to make a financial gain. However, the Group notes ELEXON's advice that, if it has evidence to believe this is occurring, it will raise a Trading Dispute on behalf of all Parties and covering all eligible runs.

The Group noted that its choice of implementation approach for P235 (i.e. whether the inconsistencies between the Code and the FAA's interest calculation would be removed prospectively or retrospectively) would affect which Reconciliation Runs remained open to a potential Dispute. Section 4 provides further details of the Group's discussions in this area.



What would be the cost of aligning FAA systems with the Code?

The FAA initially estimates this cost at £100k.

This excludes the central costs of recalculating eligible historic interest charges if a Trading Dispute was successfully raised and upheld.

3.1 Costs and impacts if P235 is approved

P235 will have no impact on Parties' systems or processes, as it will align the Code with the calculations which have been undertaken by the FAA since NETA Go-Live.

Implementation of P235 will also have no impact on the FAA, who will continue to use the existing methodology.

The Group notes that minor ELEXON implementation costs will be incurred in updating the Code and the FAA Service Description (which is based on the Code drafting and will therefore also need amendment):

- ELEXON will require 2 Working Days' lead time from the Authority decision to make the necessary Code updates and notify these to industry. This will involve 1 man day of ELEXON effort (equating to **£220**).
- If P235 is approved, the Group agrees that ELEXON will update the FAA Service Description as part of the next available BSC Release to follow the Authority's decision. This will involve 2 man days of ELEXON effort (equating to **£440**).

There is no impact on the Transmission Company.⁵

3.2 Costs and impacts if P235 is rejected

The Group notes that, if P235 is rejected, ELEXON will align the FAA systems with the Code provisions going forwards. The Group agrees that this is not desirable, since it believes that the FAA methodology is fairer and/or more accurate.

The central cost of changing FAA systems has been initially estimated at **£100,000**. The Group notes that these costs will be avoided if P235 is approved. Several respondents to the Group's consultation have indicated that rejection of P235 would also result in costs to their organisations in amending their own systems which check the calculation of their Trading Charges. Of these, two are unable to provide specific details of the magnitude of these costs but one estimates that they would be in the region of £15k.⁶

Additionally, the Group notes that rejection of P235 would leave it open for Parties to raise Trading Disputes against historic interest charges (within the limits of the Section W Disputes process). This would itself incur costs to ELEXON in processing the Disputes and recalculating past charges if one or more Disputes were upheld. The magnitude of these costs is currently unknown.⁷ Section 4 explains the Group's views on the appropriateness of such Trading Disputes.

⁵ The Transmission Company's full impact assessment is available [here](#).

⁶ You can download copies of the full Assessment Consultation responses [here](#).

⁷ Recalculation of past charges would require an Extra Settlement Determination (as only interest amounts would change and not the actual Metered Volumes held in Settlement), requiring TDC approval. It is unlikely that the FAA systems would be used to recalculate each affected run, due to the potential cost. ELEXON might therefore develop a different (auditable) system to establish each Party's amended liability.



What criteria has Ofgem previously used for retrospection?

"The particular circumstances which could give rise to the need for a retrospective rule change could, for instance, include:

- 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 participants in advance, allowing the detail and process of the change to be finalised with retrospective effect."

The Group's two solutions differ only in their implementation approaches.

This section explains the two approaches chosen by the Group, and why it believes that other implementation approaches are less appropriate.

4.1 Prospective or retrospective implementation

The Group notes that P235 can be implemented either:

- **Prospectively** (i.e. forwards from the Authority decision), leaving Parties the ability to raise Trading Disputes against eligible historic interest calculations; or
- **Retrospectively** (i.e. going backwards to a certain historic point in time), removing Parties' ability to raise Trading Disputes against interest calculations which occurred after that point.

The Group notes that the difference between the two approaches is the effect on Parties' ability to raise a Trading Dispute as, even under the prospective approach, ELEXON does not itself intend to amend historic charges.

Table 3 summarises the arguments which the Group has identified for and against a retrospective implementation.

Table 3 – Arguments for and against retrospection

Arguments against retrospection	Arguments for retrospection
<ul style="list-style-type: none"> • There is a general presumption in law against retrospective rule changes, as these can be damaging to market certainty and confidence (and thereby to competition) • A retrospective implementation removes Parties' ability to raise a Trading Dispute for some or all historic interest calculations (depending on the point of retrospection), which could be viewed as anti-competitive if you believe that Parties should retain the ability to challenge past interest calculations which were inconsistent with the Code 	<ul style="list-style-type: none"> • Retrospection can be justified in certain circumstances as shown in past Authority decisions⁸ • P235 appears to meet one of the criteria previously referred to by Ofgem for a retrospective implementation, since it relates to a situation which is 'directly attributable to central arrangements' • P235 is an unusual case, in that a retrospective implementation creates less uncertainty (by removing the potential for Trading Disputes and the reopening of Parties' past payments) and has less financial impact on Parties (by maintaining the status quo) than a prospective-only change • In this case, the benefits to competition of removing a risk therefore outweigh the removal of Parties' ability to potentially raise Disputes (an ability which the lack of Disputes to date suggests that Parties which do not wish to use) • If you agree that the existing FAA methodology is fairer and/or more accurate than the Code drafting, then a Trading Dispute could mean that Parties might be retrospectively faced with less fair/accurate (and therefore anti-competitive)

⁸ For example, BSC Modification Proposal [P210](#) 'Revisions to the Text in Section P related to Single Notifications of Energy Contract Volumes and Metered Volume Reallocations'.

Arguments against retrospection	Arguments for retrospection
	<p>charges and/or payments – protecting Parties' ability to raise such Disputes would therefore be inappropriate</p> <ul style="list-style-type: none"> • Retrospection avoids practical difficulties and inefficiencies for ELEXON (if a Dispute was upheld) in chasing Parties who have left the Code in order to obtain/make payments • Any Trading Dispute is likely to be far-reaching in scope and time-consuming to process – retrospection avoids costs to ELEXON (in processing Disputes and re-running past calculations) and Parties (in reprocessing invoices if a Dispute is upheld) which may outweigh the net materiality to Parties of the redistributed cash flows

On balance, the Group unanimously believes that a retrospective implementation is the most appropriate approach to the specific circumstances of P235 (Section 5 provides the Group's full justification against the Applicable BSC Objectives).

This view is unanimously supported by respondents to the Group's consultation (see Section 6). Respondents comment that, while they would not normally support a retrospective change, the particular circumstances of P235 justify a retrospective approach in order to confirm the status quo and avoid unnecessary uncertainty and cost.

The Group notes the intention set out in the Modification Proposal that the Proposed Modification should be a prospective-only change, as this is the more usual basis for any change and would resolve the situation going forwards. The Group agrees that this is a sensible way to reduce the risk that P235 is rejected, and that its preferred retrospective approach should be put forward as an Alternative Modification.

The Group has therefore developed:

- A **Proposed Modification** with a prospective Implementation Date of 2 Working Days after an Authority decision; and
- An **Alternative Modification** with a retrospective Implementation Date of 27 March 2001 (NETA Go-Live).

The Group has also considered a different Alternative Modification which would retrospectively remove the inconsistencies between the Code and the FAA methodology in respect of interest calculations for all Reconciliation Runs occurring on or after the day that the Panel raised P235 (9 April 2009).⁹ This particular approach has been followed with previous Modification Proposals (e.g. P210), as it could be argued that this is the point at which the possibility of a retrospective rule change was first flagged and industry uncertainty was first introduced.

However, in this case, the Group unanimously considers that it is more appropriate to go back to the point at which the inconsistencies first occurred between the FAA methodology and the Code provisions (i.e. NETA Go-Live).

⁹ This would effectively be a retrospective Calendar Day implementation. See Section 4.2 for an explanation of the difference between a Calendar Day and a Settlement Day approach.

A retrospective implementation back to NETA Go-Live will give absolute certainty and clarity that the interest calculation methodology used over the last eight years was the intended and correct calculation. This will also fully remove the risk that, if a Trading Dispute is raised, Parties might be faced with changes to their past settled charges. A retrospective 9 April 2009 implementation does not remove the possibility that a Party might raise a Trading Dispute for calculations before that date since, although the normal 20 Working Day Query deadline will have passed, there is still the potential for the Party to claim exceptional circumstances under Section W of the Code (the decision whether to allow exceptional circumstances would rest with the TDC).

This view is unanimously supported by respondents to the Group's consultation (see Section 6), whose arguments mirror those of the Group.

ELEXON has considered wider relevant legal considerations (such as statutes of limitations), and believes that these do not prevent a retrospective implementation back to NETA Go-Live.

4.2 Prospective Settlement Day or Calendar Day implementation

The Group notes that there are two possible ways to implement the Proposed Modification on a prospective basis:

1. A prospective **Settlement Day** implementation, which aligns the Code with the FAA methodology for all Reconciliation Runs relating to any Settlement Days which occur after the Implementation Date.

This approach would leave Parties the ability to raise Trading Disputes against:

- A. Any Reconciliation Runs that occur before the Implementation Date, and that fall within the deadlines for normal Trading Queries (20 Working Days from the run in which the Settlement Error occurred) or exceptional circumstances (up to 29 months from the error) if agreed by the TDC; and
- B. Any Reconciliation Runs that occur on or after the Implementation Date and which:
 - Relate to Settlement Days occurring before the Implementation Date (i.e. all runs for these Settlement Days up to 14 months after the Implementation Date, or 28 months with the Post Final Settlement Run); and
 - Are raised within the 20 Working Day Query deadline.

Reconciliation Runs for Settlement Days occurring on or after the Implementation Date would not be disputable, as there would be no inconsistencies between the interest calculations for these runs and the Code.

2. A prospective **Calendar Day** implementation, which aligns the Code with the FAA methodology for all Reconciliation Runs occurring on or after the Implementation Date (regardless of whether the Settlement Day to which the run relates falls before or after the Implementation Date).

This approach reduces the number of runs against which Parties could raise Trading Disputes, such that they could only dispute Reconciliation Runs occurring between the 20 Working Day Query Deadline for each run and the Implementation Date (or, under exceptional circumstances, occurring up to a maximum of 29 months before the Implementation Date).

All runs on or after the Implementation Date would not be disputable, as there would be no inconsistencies between the interest calculations for these runs and the Code.

Worked Example 3 on the following page further illustrates the difference between the two approaches. Again, the Group notes that the only difference between the approaches is in practice is the effect on Parties' ability to raise Disputes. The Group makes no judgement on whether such a Dispute would be upheld.

Table 4 summarises the arguments considered by the Group in favour of each approach.

Table 4 – Arguments in favour of a Settlement Day or Calendar Day approach

Arguments for a Settlement Day approach	Arguments for a Calendar Day approach
<ul style="list-style-type: none"> • More consistent with the usual implementation approach for Modification Proposals • Leaves Parties the maximum ability to raise Trading Disputes • A Calendar Day approach could be considered 'quasi-retrospective' in that it changes the interest calculation rules part-way through the Reconciliation process for transactions which have already begun¹⁰ – this gives the risk that P235 is rejected if the Authority has concerns over retrospection and/or the impact on competition of reducing Parties' ability to raise Disputes 	<ul style="list-style-type: none"> • Applies a single set of rules consistently to all Reconciliation Runs from the Implementation Date onwards, and minimises the period in which the FAA interest calculations are knowingly inconsistent with the Code – promoting clarity and transparency • Thereby represents a clearer and less complex 'line in the sand' for Parties than a Settlement Day approach (which would maintain the inconsistencies until all past Settlement Days had been through the full Reconciliation timetable), and obtains the benefits of P235 as soon as practicable • Reduces the number of Trading Disputes which can be raised, promoting competition and efficiency for the reasons given in Table 3 • Parties have been aware from the point at which P235 was raised that a Calendar Day approach could be considered, but none have raised a Trading Dispute • If full retrospection is not palatable to the Authority, a prospective Calendar Day is therefore the next best approach

¹⁰ I.e. because the Reconciliation interest calculation goes back to the Initial Settlement Run, which for some Settlement Days would have occurred before the Implementation Date.

Worked Example 3 – Settlement Day or Calendar Day approach

Following a given Settlement Day (D), a number of Settlement Runs are undertaken. These occur in accordance with the schedule set out in the Settlement Timetable.

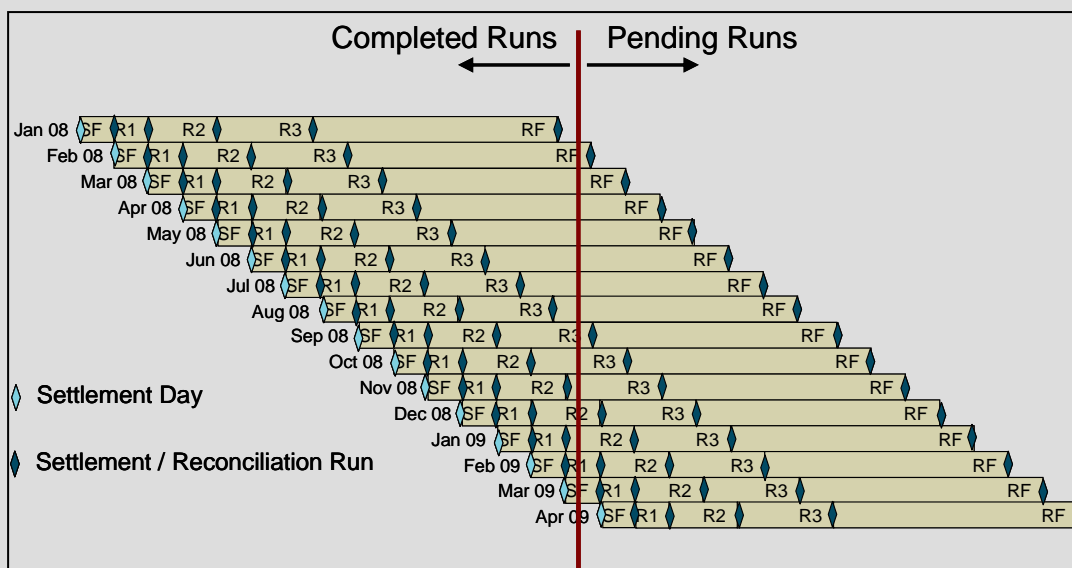
The timetable is based around:

Settlement Day	D
Initial Settlement Run (SF)	D + 16 WD
1st Reconciliation (R1)	D + 36 WD
2nd Reconciliation (R2)	D + 81 WD
3rd Reconciliation (R3)	D + 147 WD
Final Reconciliation (RF)	D + 288 WD

(WD = Working Days)

The effect is that on any given day there are a series of runs (Initial Settlement Run and Reconciliations) that have completed, and a series that are still pending.

This is illustrated in the diagram below, which for simplicity shows only one run per month.



When a Modification Proposal is approved, it is necessary to be clear on whether Settlement and Reconciliation Runs carried out after the Implementation Date of the Approved Modification in respect of Settlement Days prior to that date should be carried out under the old or the new rules.

For prospective (i.e. forward-looking) changes there are two distinct means by which they can be implemented: a Calendar Day approach or a Settlement Day approach.

The differing effects of these are demonstrated in the diagrams below. These show what the effect would be if implementation took place in April 2009. However, the pattern of effect will be the same regardless of the point from which the change prospectively applies (although the exact affected Settlement Days/Runs will be different).



What are the Applicable BSC Objectives?

- (a) The efficient discharge by the Transmission Company of the obligations imposed upon it by the Transmission Licence
- (b) The efficient, economic and co-ordinated operation of the GB Transmission System
- (c) Promoting effective competition in the generation and supply of electricity and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity
- (d) Promoting efficiency in the implementation of the balancing and settlement arrangements

The Group unanimously agrees that a Calendar Day implementation is the most appropriate approach for the prospective Proposed Modification. The Group believes that a Calendar Day approach delivers greater benefits for competition and efficiency (for the reasons outlined in Table 4) than a Settlement Day implementation.

This view is supported by a significant majority of respondents to the Group's consultation (see Section 6). The arguments made by respondents for and against a Calendar Day implementation are in line with those considered by the Group.

5 Assessment Against Applicable BSC Objectives

5.1 P235 versus existing Code drafting

The Group's unanimous view is that both the Proposed and Alternative Modifications better facilitate Applicable BSC Objectives (c) and (d) when compared with the current Code drafting.

The following reasons have been given by members against these Objectives:

Applicable BSC Objective (c):

- The existing FAA methodology more fairly and/or accurately reflects the principle behind Reconciliation and the time value of money to Parties (for the reasons described in Section 2).
- Normalising the status quo avoids costs to some Parties in changing their systems and processes to align with the Code, which would be necessary if P235 was rejected.
- Both the Proposed and Alternative Modifications therefore better promote competition than the existing Code drafting.

Applicable BSC Objective (d):

- P235 will remove any confusion and potential for misinterpretation over how Reconciliation interest is calculated, and will provide clarity and transparency to Parties.
- P235 also avoids the costs of changing FAA systems to align with the Code.
- Both the Proposed and Alternative Modifications therefore promote efficiency in the implementation and administration of the BSC arrangements.

All respondents to the Group's consultation agree that both solutions better facilitate the achievement of the Applicable BSC Objectives when compared with the current Code drafting (see Section 6). Respondents' views mirror those of the Group, although individual respondents give differing weight to arguments under Objectives (c) and (d).

No respondents or Group members believe that P235 has any effect on Applicable BSC Objectives (a) or (b).

5.2 Alternative Modification versus Proposed Modification

Of its two solutions, the Group's unanimous view is that the Alternative Modification best facilitates Applicable BSC Objectives (c) and (d) overall.

The following reasons have been given by members in support of this view:

Applicable BSC Objective (c):

- Certainty is beneficial for competition. The fact that all Parties have paid their Trading Charges (including the interest calculated by the FAA) since NETA Go-Live without dispute has provided certainty for this element of Party cash flows. Any Trading Dispute has the potential to retrospectively change and redistribute these past cash flows according to a less fair/accurate calculation of interest charged and/or received, going back to an as yet undetermined time. This would be anti-competitive.
- A retrospective implementation back to NETA Go-Live gives maximum certainty to all Parties (whether you are a 'winner' or 'loser'), promoting competition.
- In the specific case of P235, the certainty provided by retrospection outweighs any potentially anti-competitive effect of removing Parties' ability to raise Trading Disputes over how past interest was calculated. The fact that no Party has raised a Dispute to date suggests that Parties do not wish to use this ability. An upheld Dispute would result in costs to Parties in reprocessing invoices, while the net materiality to Parties of the redistributed cash flows may be low.
- Although the Proposed Modification delivers the benefits of certainty going forwards (with its Calendar Day implementation ensuring that all runs on or after the Implementation Date are subject to the same clear set of rules, and that there is no remaining period of inconsistency), it retains the risk that past interest calculations could be recalculated through a Trading Dispute. The Alternative Modification gives greater benefits to competition, by completely removing this risk and giving absolute certainty that the methodology used since NETA Go-Live has been the intended and correct calculation.

Applicable BSC Objective (d):

- Removing the potential for Trading Disputes to be raised against interest calculations will mean greater efficiency for ELEXON in administering the BSC arrangements – by removing the resource involved in processing Disputes, the costs of re-running past calculations (if a Dispute was upheld), and the inefficiencies in chasing Parties who have left the Code in order to obtain/make payments.
- Although the Proposed Modification delivers the efficiency benefits of removing potential Disputes going forwards (with its Calendar Day implementation meaning that there is no remaining disputable period of inconsistency), it retains the potential inefficiencies and central costs of Disputes being raised against historic calculations.
- The Alternative Modification gives absolute clarity regarding the calculation rules at any point in time.

Section 4 explains these arguments in more detail.

All respondents agree that the Alternative Modification better facilitates the Applicable BSC Objectives compared with the Proposed Modification, although individual respondents give differing weight to specific arguments and the two relevant Applicable BSC Objectives.

The Group's unanimous recommendation to the Panel is that the Alternative Modification should be made.



What are consultation respondents' views?

All respondents unanimously support the Alternative Modification as the best solution, and believe it is appropriate to retrospectively align the Code with the FAA methodology from NETA Go-Live

6 Assessment Consultation Responses

Table 5 summarises the responses which the Group received to its industry consultation.

Table 5 – P235 Assessment Consultation responses

	Question	Responses	Group's conclusion:	See:
1	Does the Proposed Modification better facilitate the Applicable BSC Objectives compared with the existing Code drafting?	5 Yes 0 No	Better facilitates	Section 5
2	Should the Proposed Modification apply on a prospective: <ul style="list-style-type: none"> Settlement Day basis; or Calendar Day basis? 	1 Settlement Day 4 Calendar Day	Calendar Day	Section 4
3	Does the Alternative Modification better facilitate the Applicable BSC Objectives compared with the existing Code drafting?	5 Yes 0 No	Better facilitates	Sections 4 & 5
4	Does the Alternative Modification better facilitate the Applicable BSC Objectives compared with the Proposed Modification?	5 Yes 0 No	Better facilitates	Sections 4 & 5
5	Would P235 avoid your organisation incurring costs to align your systems and processes with the Code drafting?	3 Yes 2 No	P235 means avoided costs to some Parties	Section 3
6	Are there any other implementation approaches which would better facilitate the Applicable BSC Objectives when compared with those developed by the Group (e.g. a retrospective Implementation Date of 9 April 2009, the date that P235 was raised)?	0 Yes 5 No	Chosen approaches remain appropriate	Section 4

The Group also requested an impact assessment from the Transmission Company, who confirms that it is not impacted by P235. The Transmission Company believes that both the Proposed and Alternative Modifications would better facilitate the achievement of Applicable BSC Objectives (c) and (d) compared with the existing Code drafting, but does not express a preference between the two solutions.

You can download the full consultation responses and the Transmission Company's impact assessment [here](#).



Has the legal text changed from that included in the original Modification Proposal?

Yes, the Group has made minor changes to reflect its chosen implementation approaches and two additional points of clarity

Attachments B and C contain copies of the Group's agreed legal text for the Proposed Modification and Alternative Modification.

The legal text for both solutions amends Section N6.4 of the Code to reflect that interest for Reconciliation Charges is calculated:

- Over a period from (and including) the Payment Date of the Initial Settlement Run up to (but not including) the Payment Date of the current Reconciliation Run; and
- On a daily basis using the relevant Base Rate applicable to each day in the period, and that the interest calculated on each day includes interest levied on previous days in the period (i.e. compound rather than simple interest).

Since its consultation, the Group has agreed minor changes to the version of the legal text which ELEXON initially suggested in the Modification Proposal.¹¹

These changes:

- Reflect its chosen implementation approaches for the Proposed and Alternative Modifications; and
- Reflect the following two additional points of clarity regarding the application of a daily Base Rate under the FAA systems methodology:
 - The Base Rate used by the FAA for each day in the interest calculation period is the prevailing Base Rate as at 00:00 hours at the start of the relevant day (with the exception of days falling between the issuing of the Advice Note and the Payment Date – see bullet below). If the Base Rate changes during a day, this is therefore not taken account of until the beginning of the following day.
 - Advice Notes for Parties' Reconciliation Charges and accompanying interest are issued by the FAA in advance of the Payment Date for the relevant Reconciliation Run (typically 3 Working Days before). The Base Rate used for days from (and including) the day that the Advice Note is issued and up to (but not including) the Payment Date is the Base Rate prevailing at 00:00 on the day that the Advice Note is issued. Advice Notes are not reissued if the Base Rate changes in this short (3-day) period.

The Group agrees that the draft legal text for the Proposed Modification and the Alternative Modification delivers its intended solution.

155/06 Attachment A

P235

Detailed Assessment

7 May 2009

Version 1.0

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¹¹ The Modification Proposal noted that the Group would need to develop the exact wording of the text.



Where can I find other P235 documents?

Visit the P235 page of ELEXON's website [here](#)

Table 6 – Assessment Procedure timetable

Date	Assessment activity
09/04/09	BSC Panel raises P235
09/04/09	ELEXON presents the Initial Written Assessment (IWA) to the Panel / Panel submits P235 to the Assessment Procedure
15/04/09	Modification Group holds its first meeting
17/04/09	ELEXON issues the Assessment Consultation request to industry
30/04/09	Participants return Assessment Consultation responses
01/05/09	Modification Group holds its second meeting (by teleconference)
08/05/09	ELEXON submits the Group's Assessment Report to the Panel
14/05/09	ELEXON presents the Group's Assessment Report to the Panel

Table 7 – Estimated P235 progression costs up to an Authority decision¹²

Meeting cost	External legal/ expert cost	BSC Agent impact assessment cost	ELEXON resource
£500	Zero	Zero	17 man days (£5,500)

Table 8 – P235 Modification Group attendance

Member	Organisation	15/04/09	01/05/09
Chris Rowell	ELEXON (Chair)	Y	Y
Kathryn Coffin	ELEXON (Lead Analyst)	Y	Y
Steve Wilkin	ELEXON (Proposer's Representative)	Y	Y
Gary Henderson	SAIC	Y	N
Hannah McKinney	EDF	Y	Y
Chris Stewart	Centrica	Y	N
Edward Hunter	RWE	Y	N
Howard Gregory	RWE	Y	Y
Andy Colley	SSE	N	N ¹³
Esther Sutton	E.ON	N	N
Attendee	Organisation	15/04/09	01/05/09
Abid Sheikh	Ofgem	Y	Y
Cathy Wheeler	Ofgem	N	Y
Diane Mailer	ELEXON (Lawyer)	Y	Y

155/06 Attachment A
P235
Detailed Assessment

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¹² These costs are lower than those originally provided in the IWA, as industry interest in the modification has been less than expected (requiring less ELEXON resource).

¹³ These members provided their views to ELEXON before the meeting.

P235 – PROPOSED DRAFT LEGAL TEXT

SECTION N: CLEARING, INVOICING & PAYMENT (Version 10)

Amend paragraph 6.4.2 to read as follows:

6.4.2 Subject to paragraph 5, each Payment Party shall following each Reconciliation Settlement Run be liable to pay to, or (as the case may be) entitled to receive from, the BSC Clearer an amount calculated as being:

- (a) the amount of the difference determined under paragraph 6.4.1; plus
- (b) ~~an amount in lieu of~~ interest₂ calculated ~~by applying the Base Rate to on a compound basis in accordance with paragraph 6.4.2A (“the interest amount”) on the amount of such difference, in respect of the period since the last Payment Date to the relevant Reconciliation Payment Date.~~

Insert new paragraph 6.4.2A to read as follows:

6.4.2A The interest amount shall be calculated in respect of the period from (and including) the Payment Date relating to the Initial Settlement Run to (but not including) the relevant Reconciliation Payment Date by applying the Base Rate:

- (a) as prevailing at 00:00 hours on the relevant day on a daily basis to the amount of such compounded difference up to (but not including) the Advice Note Date; and
- (b) as prevailing at 00:00 hours on the Advice Note Date on a daily basis to the amount of such compounded difference up to (but not including) the relevant Reconciliation Payment Date.

Insert new paragraph 6.4.2B to read as follows:

6.4.2B Paragraphs 6.4.2 and 6.4.2A shall apply to all Reconciliation Settlement Runs occurring on or after the Relevant Implementation Date.

P235 – ALTERNATIVE DRAFT LEGAL TEXT

SECTION N: CLEARING, INVOICING & PAYMENT (Version 10)

Amend paragraph 6.4.2 to read as follows:

6.4.2 Subject to paragraph 5, each Payment Party shall following each Reconciliation Settlement Run be liable to pay to, or (as the case may be) entitled to receive from, the BSC Clearer an amount calculated as being:

- (a) the amount of the difference determined under paragraph 6.4.1; plus
- (b) ~~an amount in lieu of~~ interest₂ calculated ~~by applying the Base Rate to on a compound basis in accordance with paragraph 6.4.2A (“the interest amount”) on the amount of such difference, in respect of the period since the last Payment Date to the relevant Reconciliation Payment Date.~~

Insert new paragraph 6.4.2A to read as follows:

6.4.2A The interest amount shall be calculated in respect of the period from (and including) the Payment Date relating to the Initial Settlement Run to (but not including) the relevant Reconciliation Payment Date by applying the Base Rate:

- (a) as prevailing at 00:00 hours on the relevant day on a daily basis to the amount of such compounded difference up to (but not including) the Advice Note Date; and
- (b) as prevailing at 00:00 hours on the Advice Note Date on a daily basis to the amount of such compounded difference up to (but not including) the relevant Reconciliation Payment Date.

Insert new paragraph 6.4.2B to read as follows:

6.4.2B The Implementation Date for paragraphs 6.4.2 and 6.4.2A shall be the Go-live Date.