

Modification proposal:	Balancing and Settlement Code (BSC) [P249]: Revision of banking arrangements under the Balancing and Settlement Code (BSC) (P249)		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	National Grid Electricity Transmission Plc (NGET), Parties to the BSC and other interested parties		
Date of publication:	26 May 2010	Implementation Date:	3 June 2010

Background to the modification proposal

Parties to the BSC are required to pay Trading Charges³ which are charged 29 days after a settlement day. Parties are required to provide credit cover for these Trading Charges. This credit cover ensures that ELEXON has enough collateral to cover a party's Trading Charges for that settlement day should they not be able to make the payment themselves.

Parties can lodge cash or a letter of credit with the BSC Banker (Barclays). The cash is held in the 'Reserve Account' and is used to make payments covering the Trading Charges of the party if needed. The Reserve Account is the main account that all the transactions related to trading charges and cash credit cover occurs. Any interest payments that are due to parties would be paid from the Reserve Account. The Reserve Account is an overnight account as it is the account from which trading charges will be met if a party fails to pay. Over the last two financial quarters the Reserve Account has held a balance of around £100 million.

The money lodged in the Reserve Account is the absolute property of ELEXON Clear but can only be used as credit cover for trading balances as set out in the BSC. ELEXON Clear is the legal counter-party to balance and imbalance transactions under the BSC and is wholly owned by ELEXON. ELEXON Clear has the same Directors as ELEXON and has a broadly similar Memorandum and Articles of Association. ELEXON Clear is referred to in the BSC as the BSC Clearer. Parties can withdraw cash from the reserve account, but they must give 10 days notice. Any interest earned on the money is paid to the party on a quarterly basis.

Currently the BSC only allows for credit cover cash payments to be held in one overnight account with the BSC Banker. The BSC Panel raised P249 as it considers the current processes overly restrict the way ELEXON Clear manages these monies. The modification seeks to allow greater flexibility in their management to diversify risk and enable a more efficient and economic approach.

The modification proposal

P249 proposes to modify the BSC to:

- Allow the Funds Administration Agent (FAA) to establish the means by which ELEXON Clear can facilitate the transfer of Reserve Account money between the Reserve Account and an 'Investment Account';

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

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

³ A definition of Trading Charges can be found on ELEXON's website - <http://www.elexon.co.uk/glossary/glossarydefinition.aspx?termID=555>

- Allow ELEXON to give a written direction to the FAA to transfer certain amounts of money between the Reserve Account and an Investment Account under the terms described in the Treasury Policy (approved by the ELEXON Board);
- Require ELEXON to notify parties to the code when the Board amends the Treasury Policy. Any changes that occur must not come into effect until 15 business days after ELEXON has notified parties of the change;
- Require ELEXON to provide a copy of the Treasury Policy to parties on request;
- Inserts new definitions for 'Investment Account' and 'Treasury Policy'; and
- Inserts a paragraph into section N that prevents ELEXON from transferring the money in the Investment Account to any other account other than the Reserve Account.

The proposal will allow the FAA, acting on written instruction from ELEXON, to facilitate and manage the transfers of Reserve Account money. All instructions given would be in accordance with the Treasury Policy, as governed and approved by the ELEXON Board.

ELEXON has received external legal advice that the changes will not require the ELEXON Group to be authorised by the Financial Services Authority (FSA).

BSC Panel⁴ recommendation

The Draft Modification Report was considered by the BSC Panel at its meeting on 8 April 2010. The Panel agreed that the Proposed Modification P249 better facilitated the applicable BSC objective d) when compared to the current arrangements. The Panel unanimously recommended that P249 should be approved.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 14 April 2010. The Authority has considered and taken into account the responses to ELEXON's⁵ consultation which are attached to the FMR⁶. The Authority has also carefully considered the legal text and this decision is based on version 4.0 sent to the Authority on 21 May 2010. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the BSC⁷; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties⁸.

Reasons for the Authority's decision

The Authority agrees with the Panel that the Proposed Modification P249 will better facilitate relevant code objective d) for the reasons set out below. Given this, we agree with the view of the Panel that P249 should be made.

⁴ The BSC Panel is established and constituted pursuant to and in accordance with Section B of the BSC.

⁵ The role and powers, functions and responsibilities of ELEXON are set out in Section C of the BSC.

⁶ BSC modification proposals, modification reports and representations can be viewed on the ELEXON website at www.elexon.com

⁷ As set out in Standard Condition C3(3) of NGET's Transmission Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=4151

⁸ 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.

During the consultations on P249 a number of concerns were raised by respondents. These concerns were focused mainly around the details of the Treasury Policy. We note that this modification facilitates the use of a Treasury Policy which determines how monies are transferred from the reserve account into investment account(s) and the nature and detail of these accounts. The Treasury Policy in itself is a matter for the ELEXON Board. The detail of the Treasury Policy is therefore not the subject of this decision but we note Elexon's willingness to amend the Treasury Policy following these consultation responses.

As part of our review of the modification we considered that the legal text provided did not fully support the modification proposal. While we note that the Treasury Policy will govern the operational decisions on investment of credit cover monies we considered that the legal text for modifying the BSC could have set out more clearly the constraints surrounding these operational decisions. Changes have been made to the legal text to better reflect the intention of the modification proposal and a final version of the legal text was received by Ofgem on 21 May 2010 following the BSC panel meeting. The changes make clear that the money from the reserve account can only be transferred into an Investment Account(s) and no further, and that the Investment Account(s) will be interest bearing. We consider that the changes will ensure that the BSC aligns more effectively with the intent of the modification proposal.

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

One respondent was concerned that the costs of implementing and maintaining P249 would be unfairly spread across all parties whether or not they deposited money into the Reserve Account and that the benefits may not outweigh the costs of the modification.

The group provided estimates of the implementation costs and on-going costs of P249. They estimated that it would require a Service Provider effort amounting to £1300 to produce a new spreadsheet to calculate the interest due to Parties based on varying rates of return. The Service Provider considered that there would be no additional operational costs or any impact to the BSC Central Systems.

The group unanimously agreed that the reduced operational risk coupled with the minimal costs for ELEXON would facilitate Applicable BSC Objective (d). We consider that the costs in implementing and maintaining P249 would be negligible when spread across parties.

ELEXON also provided estimates of the possible gains should P249 be implemented. With the current interest rate on the Reserve Account it has the potential to earn interest of about £24,658 over a 30 day period. Using the current interest rates from other investment accounts they estimated that under P249 the interest earned over a period of 30 days could be in the region of £63,337⁹. Considering the estimates provided we are comfortable that the benefits would out-weigh the costs.

Another concern raised by a respondent was that the modification group did not consider what would happen if any of the financial institutions that the money was invested in should fail. The group did not feel that this came under the scope of the modification. We agree and note that diversification of risk may in any case improve this situation. We also note that any investments made under the Treasury Policy of Reserve Account

⁹ Please see the FMR on ELEXON's website to find a more detailed explanation of the projected benefits of this modification - www.elexon.com.

monies should be very low risk and not speculative in nature as the money being held is credit cover.

We also note that providing cash credit cover is not mandatory. Therefore, if parties are uncomfortable with the terms of the Treasury Policy, and future changes, being implemented they can provide a Letter of Credit instead of providing cash cover.

The modification group concluded that, if implemented, P249 would better facilitate relevant objective (d) by diversifying and reducing the overall financial risk to the cash credit cover. They also noted that money deposited in term accounts had the potential to achieve a higher rate of return than money kept in an overnight account. They felt that P249 would introduce greater flexibility and efficiency into the settlement of financial obligations between BSC Parties and ELEXON.

We agree that P249 will facilitate relevant objective (d) by increasing the efficiency in which a party's credit cover is handled. We also consider that by enabling ELEXON to vary its treatment of the Reserve Account money, in particular by splitting it between a number of financial institutions, has the potential to reduce risk. It has also has the potential to reduce risk in the extreme scenario that one of the financial institutions should fail.

Decision notice

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority, hereby directs that modification proposal BSCP249: Revision of Banking Arrangements under the BSC be made.

Mark Cox
Associate Partner, Licensing and Industry Codes

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