ELEXON

Draft MODIFICATION REPORT for Modification Proposal P142

Minor refinement to allow a Level 2 Default Cure period in defined circumstances

Prepared by: ELEXON on behalf of the BSC Panel

Date of issue:	19/12/03	**Document reference:**	MRP142
Reason for issue:	For Industry Consultation	**Issue/Version number:**	Draft/0.2

This document has been distributed in accordance with Section F2.1.10[1] of the Balancing and Settlement Code.

RECOMMENDATIONS

The Balancing and Settlement Code Panel recommends that:

- **Proposed Modification P142 should not be made;**
- **If the Authority determines that P142 should be made, the Implementation Date should be 3 November 2004, if an Authority determination is received before or on 23 March 2004. If an Authority determination is received after that date but before or on 13 July 2004, the Implementation Date should be 23 February 2005; and**
- **The development and implementation costs for Proposed Modification P142 of £487,130 and ELEXON effort of 138 man days, with an additional 30% tolerance associated with these estimates, be noted.**

[1] The current version of the Balancing and Settlement Code (the 'Code') can be found at www.elexon.co.uk/ta/bscrel_docs/bsc_code.html

CONTENTS TABLE

SUMMARY OF IMPACTED PARTIES AND DOCUMENTS

The following parties/documents have been identified as being potentially impacted by Modification Proposal P142.

Parties	
Suppliers	☒
Generators	☒
Licence Exemptable Generators	☒
Transmission Company	☐
Interconnector	☒
Distribution System Operators	☐
Party Agents	
Data Aggregators	☐
Data Collectors	☐
Meter Operator Agents	☐
ECVNA	☐
MVRNA	☐
BSC Agents	
SAA	☐
FAA	☒
BMRA	☐
ECVAA	☒
CDCA	☐
TAA	☐
CRA	☐
Teleswitch Agent	☐
SVAA	☐
BSC Auditor	☐
Profile Administrator	☐
Certification Agent	☐
MIDP	☐
TFLA	☐
Other Agents	
SMRA	☐
Data Transmission Provider	☐

Sections of the BSC	
A	☐
B	☐
C	☐
D	☐
E	☐
F	☐
G	☐
H	☐
J	☐
K	☐
L	☐
M	☒
N	☐
O	☐
P	☐
Q	☐
R	☐
S	☐
T	☐
U	☐
V	☐
W	☐
X	☒

Code Subsidiary Documents	
BSC Procedures	☐
Codes of Practice	☐
BSC Service Descriptions	☒
Service Lines	☐
Data Catalogues	☒
Communication Requirements Documents	☐
Reporting Catalogue	☐
MIDS	☐
Core Industry Documents	
Grid Code	☐
Supplemental Agreements	☐
Ancillary Services Agreements	☐
Master Registration Agreement	☐
Data Transfer Services Agreement	☐
British Grid Systems Agreement	☐
Use of Interconnector Agreement	☐
Settlement Agreement for Scotland	☐
Distribution Codes	☐
Distribution Use of System Agreements	☐
Distribution Connection Agreements	☐
BSCCo	
Internal Working Procedures	☒
Other Documents	
Transmission Licence	☐

X = Identified in Report for last Procedure
N = Newly identified in this Report

Cost of implementing Proposed Modification:	**£20,000 + 53 ELEXON man days**
Change specific	£62,379
Standalone Release Cost	£252,933
BSC Auditor Effort	£31,531
Clarification of Solution	£15,766
Additional ELEXON Release Costs	£80,000
Operational/maintenance	£44,521
Total:	**£ 487,130 + 138 ELEXON man days**

1 DESCRIPTION OF PROPOSED MODIFICATION AND ASSESSMENT AGAINST THE APPLICABLE BSC OBJECTIVES

1.1 Modification Proposal

Modification Proposal P142 "Minor refinement to allow a Level 2 Default Cure period in defined circumstances" ('P142') was raised by Total Gas & Power Ltd on 29 August 2003 (reference 1).

The Panel considered the Initial Written Assessment for P142 at its meeting of 11 September 2003. The Panel submitted the Proposal to a three month Assessment Procedure, with the assessment undertaken by the Settlement Standing Modification Group (SSMG).

P142 proposes that where a Trading Party's Credit Cover Percentage (CCP) exceeds 90% but remains below 100% outside normal business hours then a Level 2 Credit Default Cure Period shall exist, and shall last until two hours into the next Business Day. Prior to the expiry of the Level 2 Credit Default Cure Period, the Trading Party shall not be considered to be in Credit Default and the Credit Default Refusal and Rejection Periods shall not commence.

The purpose of the Level 2 Credit Default Cure Period is to allow the Trading Party the opportunity to lodge additional Credit Cover during banking hours.

The Proposer contends that, due to restrictions on banking hours, it is currently not feasible for a Party to resolve a Level 2 Credit Default outside business hours by lodging additional Credit Cover. The Proposer further suggests that a lack of sufficient liquidity on the traded power exchanges at such times may reduce the opportunities available to the Party to trade out of Credit Default.

It is argued that this combination of restrictions may mean that a Party who breaches 90% CCP over a weekend or Public Holiday period may not be able to extricate themselves from this circumstance, even if they are financially sound and wish to resolve the breach. A consequence of this is that they may be exposed to significant imbalance charges should a Credit Default Rejection or Refusal Period commence. The consequences of a Credit Default Rejection Period or a Credit Default Refusal Period are prescribed in Section M3.3 of the Balancing and Settlement Code ('the Code'), but may be briefly summarised as a restriction on the ability of the Party to lodge new Volume Notifications that do not decrease CCP in the case of the former, and an ongoing rejection of components of existing Volume Notifications that do not decrease CCP in the case of the latter.

It is contended that the intention of Credit Default procedures, to provide protection for the market against exposure to the unpaid Trading Charges of a Party in genuine financial difficulties, needs to be pragmatically balanced against the ability of a financially sound BSC Party to resolve Credit Default circumstances without being exposed to significant imbalance charges. The Proposer suggested that P142 better achieves this balance and therefore better facilitates Applicable BSC Objectives (c) and (d).

During the Assessment Procedure for P142, the SSMG met three times, on 17 September 2003, 21 October 2003 and 18 November 2003. The SSMG have undertaken one consultation and one impact assessment from the BSC Parties, BSC Agents, BSCCo and the Transmission Company.

The Panel considered the Assessment Report and the SSMG recommendations in respect of P142 at its meeting of 11 December 2003. The Panel concluded that P142 should not be made.

1.2 Proposed Modification

The SSMG agreed that a Party would have been deemed to have made payment within the Level 2 Credit Default Cure Period if the FAA were to have confirmed receipt of the additional Credit Cover within the two hour window. In addition, the FAA and ECVAA would have a further period within which to action the revised ECC for the Party.

The FAA and ECVAA would have one hour from the time at which the FAA has confirmed receipt of additional Credit Cover from the Party in which to ensure that the ECVAA record of ECC is updated.

In response to legal advice, the BSC Agent processing window has been included within the Level 2 Credit Default Cure Period rather than as a separate provision commencing upon its expiry. This has been achieved by prescribing that the Level 2 Credit Default Cure Period be considered to expire at 12:00 hours on the relevant day, with an obligation on the FAA to update the ECVAA regarding receipt of funds by this time if payment has been received by 11:00 hours. Applying the Level 2 Credit Default Cure Period in this way was considered to lead to a simpler legal baseline than two separate windows, whilst simplifying the timings of the authorisation notice needed to give effect to Level 2 Credit Default.

The ECVAA put forward two solutions for P142 which are detailed in more depth in the Assessment Report for Modification Proposal P142 (P142AR, reference 6).

The first of these (referred to as the 'Original Solution') was based around an automated solution that parameterised the Level 2 Credit Default Cure Period into ECVAA software.

The second ('Alternative Solution') was based around a semi-manual workaround that reduced ECVAA software changes to the issuing of a new data flow upon 100% CCP breaches and did not parameterise the Level 2 Credit Default Cure Period. The BSCCo would synthetically create the Level 2 Credit Default Cure Period by timing the issuing of authorisation notices such that ECVAA did not inadvertently put the qualifying Party into Credit Default.

The change specific costs attributed to these two solutions were £117,841 and £51,579 respectively in ECVAA costs. In addition, the Alternative Solution would incur a further £8,800 in BSCCo change specific costs.

The Modification Group agreed that the Alternative Solution should be used as this would reduce costs. The Group believed that Level 2 Credit Default Cure Periods would be triggered sufficiently infrequently that system robustness would not be comprised by adoption of a semi-manual workaround.

1.3 Issues raised by the Proposed Modification

The following issues were considered during the Assessment of P142:

- Principles of Credit Cover and the Energy Indebtedness calculation;
- Level 1 Credit Default;
- Level 2 Credit Default;
- Interaction between Level 1 and Level 2 Credit Default;
- Definition of Business Hours;
- Credit Cover Percentage Thresholds;
- Use of the Query Period to address 90% Credit Cover Percentage breaches;
- Frequency of incidents;
- BSC Agent processing window;
- The Terms of Reference; and
- Possible implementation solutions.

A Requirements Specification (reference 3) was issued to the industry on 3 October 2003 seeking impact assessments from the BSC Agents, BSC Parties, BSCCo and Transmission Company. A

Consultation Document (reference 5) was issued on 3 November 2003 seeking comment on the principles and issues raised by P142 from BSC Parties and the Transmission Company.

The SSMG deliberations on these issues are detailed within the Assessment Report for Modification Proposal P142 (P142AR, reference 6). Therefore the issues are not detailed further in this Modification Report.

1.4 Assessment of the Proposed Modification in respect of the Applicable BSC Objectives

The Modification Group agreed that P142 did not dilute the deterrent effect of Level 2 Credit Default as the treatment of 100% CCP breaches would remain unchanged, and Parties would therefore still be incentivised to reduce high levels of CCP to avoid the risk of Volume Notification refusal or rejection. Additionally, P142 provides that where a Level 2 Credit Default Cure Period lapsed without the Party taking action to reduce their CCP below 90% that they should be considered to be in Level 2 Credit Default with a Credit Default Rejection and Refusal Period triggered. The Modification Group therefore agreed that the market would not be unnecessarily exposed to risk by P142.

The Modification Group considered that P142 would facilitate competition in the market for several reasons.

It may reduce incentives for the over-provision of Credit Cover. P142 seeks to avoid the circumstance whereby a Party may enter authorised Level 2 Credit Default with a CCP of under 100% and without having had an opportunity to lodge additional Credit Cover. Parties may be providing excessive levels of Credit Cover in order to avoid the risk of this occurrence. P142 may provide assurance that will allow Parties to lodge Credit Cover at more realistic levels.

The easing of such incentivisation towards over-provision of Credit Cover may also remove a barrier to entry to the market by reducing the collateral needed by a new market entrant.

Additionally, the Modification Group considered that P142 may ameliorate perverse incentives on trading behaviour resulting from Level 2 Credit Default. It was considered that under the current baseline, where no Level 2 Credit Default Cure Period exists for Level 2 Credit Default, a Party breaching 90% outside business hours may be left with no alternative but to trade out of their position. This may result in the Party adopting a non-optimal trading position purely to manage their CCP. The Modification Group considered that this would be unfair on a Party whose CCP remained below 100% as they would be constricted in their ability to trade freely despite having Credit Cover in excess of their estimated outstanding Trading Charges.

The Modification Group further noted that the lack of an alternative to the Party beyond trading out of their position may impact upon System Buy and Sell Price (SBP/SSP) volatility as they may engage in trades with the Market Index Data Providers (MIDPs) with little flexibility on whether to accept energy prices quoted.

For the above reasons, the Modification Group concluded that P142 would better facilitate 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'.

1.5 Modification Group's cost benefit analysis of Proposed Modification

The development and implementation of P142 will incur costs of approximately £487,130. This encompasses BSC Central Service Agent development and implementation costs of £62,379, plus (standalone) release costs of £252,933. The annual maintenance cost for Proposed Modification P142 will be £44,251 p.a.

This includes additional BSCCo costs of:

- £31,531 (10% of the total BSC Agent cost for the BSC Auditor effort);
- £15,766 (5% of the total BSC Agent cost for any clarification to the solution during development); and
- £80,000 (fixed price for a BSCCo Release).

This excludes BSCCo effort of approximately 138 man days. There is an additional +/- 30% tolerance on the overall cost reflecting contingency against actual implementation resourcing deviating from that expected.

A lead time of approximately 32 weeks is required.

Therefore, provisional discussions indicate that:

- P142 is to be delivered in the November 2004 (3 November 2004 Implementation Date) BSC Systems release, if an Authority determination is received on or by 23 March 2004; and
- P142 is to be delivered in the February 2005 (23 February 2005 Implementation Date) BSC Systems release, if an Authority determination is received after 23 March 2004, but on or by 13 July 2004.

Full details of costs associated with the implementation of P142 are detailed within the Assessment Report for Modification Proposal P142 (P142AR, reference 6). Therefore the costs are not detailed further in this Modification Report.

1.6 Alternative Modification

Neither the Modification Group, nor any of the respondents to the Consultation Document identified any Alternative Modifications that would, in their opinion, better address the perceived defect.

1.7 Governance and Regulatory Framework Assessment

Neither the Modification Group, nor any of the respondents to the Consultation Document identified any impact upon the Governance and Regulatory Framework.

2 RATIONALE FOR PANEL'S RECOMMENDATIONS

The Panel noted the Modification Group's recommendations on P142 but did not agree that the Proposed Modification should be made. The conclusions of the SSMG and the Panel response to them are detailed below.

2.1 SSMG recommendations to Panel

The SSMG concluded that:

- P142 would not dilute the deterrent effect of Level 2 Credit Default or expose the market to unnecessary risk.
- P142 would facilitate more effective competition by:
    - reducing incentives for the over-provision of Credit Cover and therefore reduce the opportunity cost of excessive collateral being lodged for this purpose. This would not only benefit existing Parties but also potentially reduce barriers to entry through a decrease in the amount of collateral required for Credit Cover for new Parties; and
    - removing perverse incentives upon a Party whose Credit Cover exceeds their estimated Trading Charges, but who has breached 90% CCP outside business hours, to

potentially submit commercially undesirable Volume Notifications purely to reduce their CCP; and

- reducing the necessity of a Party breaching 90% CCP to trade out of this position in defined circumstances. This may reduce the likelihood of trades to avert Credit Default being entered into with Market Index Data Providers, and therefore increase the likelihood that the Energy Imbalance Price calculated from Market Index Data (MID) is representative of short-term prices for energy ahead of Gate Closure in the forwards and spot markets.

For these reasons, the Modification Group concludes that P142 would better facilitate 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'.

The Modification Group acknowledged that the BSCCo had received legal advice stating that Applicable BSC Objective (d) – 'Promoting efficiency in the implementation and administration of the balancing and settlement arrangements' - is concerned with central BSCCo costs incurred in implementing and administering the Code. As no BSCCo cost savings were identified during the Assessment Procedure, P142 was not considered to better facilitate achievement of Applicable BSC Objective (d).

2.2 Panel recommendations

The Panel noted that both the Modification Group and the respondents to the Consultation Document had visibility on the proposed implementation and operational maintenance costs of P142 during the Assessment Procedure, but did not agree with the conclusions reached regarding the desirability of approval.

The Panel considered that the short duration of the Level 2 Credit Default Cure Period restricted its usefulness, as smaller Parties might not be in a position to lodge additional Credit Cover in time even were they to qualify for a Level 2 Credit Default Cure Period.

The Panel further believed that the benefits of P142 would accrue to an affected Party, rather than the industry as a whole. The Panel was unconvinced such costs should be borne by the wider BSC community.

The Panel noted that P142 scenario incidents have been extremely rare historically. The Panel therefore believed that costs incurred to implement P142 were likely to be significant in relation to any benefit.

The Panel concluded that costs related to the implementation and operation of P142 would outweigh any benefits. It was therefore considered that the negative impact of P142 on Applicable BSC Objective (d) – 'Promoting efficiency in the implementation and administration of the balancing and settlement arrangements' - exceeded any positive impact it might have on 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'.

The Panel therefore recommends that the Proposed Modification P142 should **not** be made.

In the event that an Authority determination to approve is received before or on 23 March 2004, the Panel recommends an Implementation Date of 3 November 2004. Should an Authority determination to approve be received after 23 March 2004 but before or on 13 July 2004, the Panel recommends an Implementation Date of 23 February 2005.

3 IMPACT ON BSC SYSTEMS AND PARTIES

3.1 BSCCo

The following impacts upon BSCCo systems have been identified:

3.1.1 Resourcing for helpdesk calls

P142 would increase the complexity of Section M provisions. BSCCo Service Delivery may see an increase in both the number of helpdesk calls relating to the application of Credit processes and in the time spent addressing these calls.

3.1.2 Need to monitor 100% CCP breaches

Under the current BSC baseline, the BSCCo issues authorisation notices upon the expiry of the Query Period except where material doubt exists. This means the BSCCo can precisely forecast when an authorisation notice should be issued.

The proposed solution will require the BSCCo to delay issuing an authorisation notice where a Level 2 Credit Default Cure Period exists in order to avoid inadvertently triggering the Credit Default Refusal and Rejection Periods parameterised within ECVAA. The Level 2 Credit Default Cure Period could end at any time should the Party breach 100% CCP.

The BSCCo will need to have robust working practices in place to ensure authorisation notices can be issued instantaneously when this happens.

3.1.3 Local Working Instructions

Local Working Instructions ('LWIs') relating to Credit Cover and Credit Default processes will need to be modified.

3.1.4 Implementation effort

Internal Impact Assessments within BSCCo have suggested that a total of 138 man days effort plus £8,800 in change specific costs would be required to implement P142.

This is broken down as follows:

- 126 man days for CVA Programme activity. 100 of these relate to software testing activity applicable to a low complexity release and may be reduced by the presence of other Modifications or Change Proposals that require software changes within the same release. The remaining 26 days is for implementing changes to: the ECVAA User Requirement Specification; ECVAA System Specification; ECVAA Design Specification; ECVAA Service Description; ECVAA Operational Services Manual; Interface Definition Document (IDD) Part 1; IDD Part 2; Business Process Model; and FAA Service Description;
- 12 man days for Assurance activity, for providing required support services to the CVA Programme; and
- £8,800 in change specific costs for Service Delivery, for putting in place LWI changes, training, development of operational service and IT requirements (laptops plus ISDN lines) for out-of-hours duty managers to manage new processes. Service Delivery additionally estimates an annual maintenance cost of between £16,200 and £33,400 dependent on the degree of out of Business Hours management of Credit Defaults required in practice.

3.2 BSC Systems

System / Process	Potential Impact of Proposed Modification
Credit Checking Systems	**New dataflow identifying 100% CCP breaches** ECVAA software will be changed such that a new flow will be sent to the BSCCo where a Party's CCP breaches the 100% CCP threshold. Operating procedures will need to be modified such that the ECVAA also telephones BSCCo to inform them this flow has been sent.
Clearing, Invoicing and Payment	**Provision of Credit Cover** Where a Party qualifies for a Level 2 Credit Default Cure Period and the FAA receives additional Credit Cover from that Party prior to 11:00 am on the next Business Day, they would have to calculate the Party's Energy Credit Cover and update the ECVAA with this information within one hour. Processing timescales for other transactions would be unaffected.

3.3 Parties and Party Agents

Six responses were received from Parties in response to the Requirements Specification, five of which indicated that P142 would have no impact in terms of costs, changes or implementation timescales.

The remaining response identified the following impacts:

- Requirement for minor changes to processes to recognise additional time available to post funds to resolve Credit Default;
- Implementation timescale of one week; and
- Minimal implementation costs.

4 IMPACT ON CODE AND DOCUMENTATION

4.1 Balancing and Settlement Code

Section M 'Credit Cover and Credit Default' would be modified to reflect the parameters of the new Level 2 Credit Default Cure Period.

Annex X-1 'General Glossary' would be amended to reflect new definitions of Business Hours and Level 2 Default Cure Period.

The draft legal text is contained within an attached document.

4.2 Code Subsidiary Documents

The following Code Subsidiary documents would need to be modified to reflect the changed BSC Systems and Processes detailed above:

- ECVAA Service Description;
- ECVAA System Specification; and
- FAA Service Description.

4.3 Configurable items

The following configurable items would need to be modified to reflect the changed BSC Systems and Processes detailed above:

- ECVAA User Requirements Specification;
- ECVAA Manual System Specification;
- ECVAA Design Specification;
- ECVAA Operational Services Manual;
- Interface Definition Document Part 1;
- Interface Definition Document Part 2; and
- Business Process Model.

4.4 BSCCo Memorandum and Articles of Association

No changes to the BSCCo Memorandum and Articles of Association have been identified as arising as a consequence of the Proposed Modification.

4.5 Impact on Core Industry Documents and supporting arrangements

No changes to Core Industry Documents or supporting arrangements have been identified as arising as a consequence of the Proposed Modification.

5 SUMMARY OF CONSULTATIONS

[Pending receipt]

5.1 Summary of the consultation responses

[Pending receipt]

5.2 Comments and views of the Panel

[Pending deliberation]

6 SUMMARY OF TRANSMISSION COMPANY ANALYSIS

6.1 Analysis

No impact has been identified resulting from this Modification Proposal that would affect the ability of the Transmission Company to discharge its obligations under the Transmission Licence.

The Transmission Company did not express an opinion as to whether P142 better facilitates the Applicable BSC Objectives.

The Transmission Company did not believe that P142 would impact the computer systems and processes of the Transmission Company, have any implementation costs for them or require any consequential changes to Core Industry Documents.

The Transmission Company had no further comments.

6.2 Comments and views of the Panel

The Panel had no comments on the Transmission Company analysis.

7 DOCUMENT CONTROL

7.1 Authorities

Version	Date	Author	Reviewer	Change Reference
0.1	15/12/03	Richard Hall	Sarah Parsons	Change Delivery Review
0.2	19/12/03	Richard Hall		

7.2 References

Ref	Document	Owner	Issue date	Version
1	Modification Proposal P142	ELEXON	29/08/03	1.0
2	P142 Initial Written Assessment (IWA P142)	ELEXON	05/09/03	1.0
3	Requirement Specification for Modification Proposal P142 'Revised Credit Cover methodology for Interconnector BM Units'	SSMG	03/10/03	1.0
4	Communications Requirement Document	ELEXON	24/06/03	7.0
5	Modification Proposal P142 Consultation Document (P142AC10)	SSMG	03/11/03	1.0
6	Assessment Report for Modification Proposal P142 (P142AR)	SSMG	05/12/03	1.0

ANNEX 1 DRAFT LEGAL TEXT

- Text for Proposed Modification is in an attached document.

ANNEX 2 MODIFICATION GROUP DETAILS

NAME	POSITION	MEMBER
Roger Salomone	Chairman	Y
Richard Hall	Lead Analyst	Y
Steve Drummond	EdF Trading Ltd	Y
Mark Manley	British Gas Trading	Y
Paul Jones	Powergen	Y
Mark Pearce	National Grid Company	Y
Sharif Islam	Total Gas & Power Ltd	Y
Rob Barnett	Campbell Carr	Y
Joanne Ellis	Cornwall Consulting Ltd	Y
Jerome Williams	Ofgem	N
Steve Mackay	Ofgem	N
Sanjukta Round	Cornwall Consulting Ltd	N
Neil Smith	Powergen	N