

October 2001

DEFINITION REPORT
MODIFICATION PROPOSAL P39 -
Improvements to the
Administration of the Payment
Default Process

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Name	Organisation
BSC Panel	

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1 SUMMARY AND RECOMMENDATIONS

See the associated document 'P39_Summary' for the Summary and Recommendations.

2 INTRODUCTION

This Report has been prepared by ELEXON Ltd., on behalf of the Balancing and Settlement Code Panel ('the Panel'), in accordance with the terms of the Balancing and Settlement Code ('BSC'). The BSC is the legal document containing the rules of the balancing mechanism and imbalance settlement process and related governance provisions. ELEXON is the company that performs the role and functions of the BSCCo, as defined in the BSC.

An electronic copy of this document can be found on the BSC website, at www.elexon.co.uk

3 PURPOSE AND SCOPE OF THE REPORT

BSC Section F sets out the procedures for progressing proposals to amend the BSC (known as 'Modification Proposals'. These include procedures for proposing, consulting on, developing, evaluating and reporting to the Authority on potential modifications.

The BSC Panel is charged with supervising and implementing the modification procedures. ELEXON provides the secretariat and other advice, support and resource required by the Panel for this purpose. In addition, if a modification to the Code is approved or directed by the Authority, ELEXON is responsible for overseeing the implementation of that amendment (including any consequential changes to systems, procedures and documentation).

The Panel may decide to submit a Modification Proposal to the 'Definition Procedure'¹. In such cases, the Panel commissions a Modification Group to define the issues raised by a Modification Proposal in sufficient detail to enable the Panel to determine whether to:

- a) Refer the proposal back to the Modification Group for further analysis; or
- b) Submit the proposal to the Assessment Procedure²; or
- c) Proceed directly to the Report Phase³.

The Modification Group is therefore tasked with reviewing the Modification Proposal with a view to providing clarification and definition where there is insufficient detail in the proposal to allow the Panel to decide whether to proceed with a detailed evaluation. The Modification Group must prepare a written report for the Panel that sets out the following matters⁴:

- a) An assessment of the issues raised by the Modification Proposal with supporting information and data to explain the effect of such issues by reference to the Applicable BSC Objective(s)⁵ and a summary of such assessment;
- b) An analysis of and the views and rationale of the Modification Group as to whether (and, if so, to what extent) the issues raised by the Modification Proposal warrant further assessment and evaluation under the Assessment Procedure;
- c) A detailed summary of the representations made by Parties and interested third parties during any consultation undertaken by the Modification Group and the comments and views of the Modification Group in respect thereof;
- d) A summary of any analysis prepared by the Transmission Company and the comments and views of the Modification Group in respect thereof;
- e) A summary of the analysis prepared by relevant BSC Agents and the comments and views of the Modification Group in respect thereof;
- f) Where applicable, a copy of the terms of reference and a summary of any report or analysis of external consultants or advisers; and

¹ See BSC F2.5

² See BSC F2.6

³ See BSC F2.7

⁴ See BSC F2.5.4

⁵ As defined in the Transmission Licence

- g) Such other matters as the Panel may require in the terms of reference of the relevant Modification Group.

This Definition Report therefore addresses all of the above items to the extent relevant to the Modification Proposal in question.

4 MODIFICATION GROUP DETAILS

This Definition Report has been prepared by the ISG Modification Group. The BSC Panel meeting on 20th September 2001 agreed that the standard Modification Group Terms of Reference should apply. Additionally, the Panel specified that the Modification Group should consider:

- Enforcing compliance with the current Code timetables;
- Introducing a requirement whereby all parties should hold bank accounts at the BSC Bank.

The Panel suggested that whilst the core Modification Group should consist of the ISG, additional financial expertise should be sought. ELEXON have therefore invited representatives from the FAA to attend the Modification Group Meeting. Also, Richard Humphreys from the Finance Department within ELEXON has joined the Modification Group and will be attending future meetings.

Members and attendees at the Modification Group meeting on the 2nd October were as follows.

Name	Organisation	Role
Justin Andrews	ELEXON	Chairman
Duncan Jack	St. Clements Services	Mods Group Member
Ben Willis	Yorkshire Electricity	Mods Group Member
Martin Mate	British Energy	Mods Group Member
Geoff Allen	Powergen	Mods Group Member
Lisa Waters	Dynegy	Mods Group Member
Maurice Smith	Campbell Carr	Mods Group Member
Ian Moss	APX	Mods Group Member
Nigel Brooks	NGC	Mods Group Member
Sarah Parsons	ELEXON	Attendee
Paul Davis	FAA	Attendee
Martin Wiles	FAA	Attendee

Please note that Justin Andrews chaired the meeting on the 2nd October, however, Chris Rowell will be the Modification Group Chairman for future meetings.

5 THE NEED FOR FURTHER ASSESSMENT AND EVALUATION

The recommendation of the Modification Group is that the Modification Proposal is submitted to the Assessment Phase. This decision was taken in light of majority of the responses received from BSC Parties that agreed changes should be made to the payment timescales documented in the Code. The majority of respondents also agreed that the concept of Payment Default Thresholds should be introduced.

Should the Modification Proposal be submitted to the Assessment Phase, the Modification Group will carry out the following:

- a) Further assessment to ensure that the full impact of changing the payment timescales documented in the Code has been considered.
- b) Further analysis to determine the most appropriate Payment Default Thresholds.
- c) Production of a draft BSCP to document the detailed payment default procedures.
- d) Consider whether any Alternative Modification Proposals would better facilitate the achievement of the BSC Objectives.

6 REPRESENTATIONS BY PARTIES AND INTERESTED THIRD PARTIES

6.1 Comments and Views of the Modification Group

Modification Proposal P39 seeks to improve the administration of the Payment Default process and highlights four areas of change within the Code. Each of these were discussed by the Modification Group at the meeting on 2nd October 2001.

6.1.1 Payment Timescales

The timescales within the Code, relating to the transfer of funds, state that parties should ensure payment is credited to the Collection Account by 12:00 on the relevant Payment Date. The FAA should determine whether the required amounts have been credited to the Collection Account by 13:00 and ensure that these are then remitted to the Clearing Account by 13:30. These timescales are not being met.

The Modification Group agreed that there were two ways that this non-compliance could be resolved. Firstly ELEXON could enforce compliance, in which case each party would be responsible for ensuring that their funds are transferred by 12:00. However, banks can only guarantee that payment made by BACs or CHAPs will be made on a particular day. They will not guarantee that payment is made by a certain time within that day. Therefore the FAA will not find out whether all payments have been received until between 15:00 and 17:00 hours depending on the payment deadline for the relevant banks. The only way for parties to ensure that payment is received by 12:00 would be to transfer the funds on the previous day. It was noted that this problem exists regardless of the bank being used. Therefore introducing a requirement for all parties to use the BSC bank would not resolve the issue. The Modification Group agreed that enforcing compliance was not a reasonable option.

The second option, as described in the Modification Proposal, would be to modify the Code. It was suggested that the specific timescales should be removed from the Code and instead Section N8 would state that payment should be made on the Payment Date and the FAA will check that all payments are received by close of banking business.

6.1.2 Payment Default Thresholds

The second proposed change relates to the introduction of payment default thresholds. At present all defaults should be progressed in the same way, regardless of the size of the default. The Modification Group agreed that the Code should be modified to refer to payment thresholds, and that the detailed procedures relating to each of the different thresholds would be documented within a new BSCP and BSCCo/FAA working procedures.

The suggested thresholds were as follows:

- A default notice would be issued on D+1 to any party with a cumulative outstanding debt of greater than [£250,000].
- A default notice would be issued on D+7 to any party with a cumulative outstanding debt of between [£50,00 and £250,000].
- A default notice would be issued on D+30 to any party with a cumulative outstanding debt of less than [£50,000].

Please note that D is the day that the cumulative outstanding debt of the BSC Party becomes greater than the relevant threshold limit.

It was noted that analysis would be carried out as part of the Assessment Procedure to determine whether more appropriate threshold limits should be used. Also there would be provision made for the threshold limits to be reviewed, and amended, by the Panel if necessary.

6.1.3 Letters of Credit

The Modification also raised an issue that Letters of Credit cannot be called on immediately and that the payment default procedure should take this into account. The Modification Group agreed that this should be considered when determining the procedures for each default threshold.

It was agreed that if the total outstanding amount being used within the Borrowing Account becomes greater than £4m (the total borrowing facility in accordance with section N4.9.1 of the Code) then the FAA would call on all relevant Letters of Credit immediately. The FAA, via ELEXON, would also seek to gain agreement from the Panel to increase the borrowing facility (up to a maximum amount of £10m). Extra interest charges would be incurred for an unauthorised overdraft limit and these would be charged to the relevant parties. If the £4m limit has not been exceeded then the timescales stated above for the different default thresholds would be used to decide when to call on Letters of Credit.

6.1.4 Payment transfers

The final area of change raised in the Modification relates to the use of banks which do not have offices in the UK. The Modification Group agreed that that an explicit statement should be added to the Code stating that the BSCCo and their agents will not pay any bank charges for payment transfers.

6.2 Summary of Consultation Responses

The Modification Group agreed to carry out a consultation as part of the Definition Procedure to allow all affected parties to provide their views on the modification. The consultation was based on the four points discussed above. The representations received in response are in Annex 2 of this document. Ten responses were received in total, all of which expressed support for certain aspects of the modification.

6.2.1 Payment Timescales

All respondents were in favour of modifying the Code to reflect banking reality, rather than enforcing compliance on the basis that it is not possible to guarantee the transfer of funds at a specified time within a day. One party suggested that the new deadline should be close of business, rather than close of banking business. If P39 is progressed to Assessment Procedure, the materiality of this change can be assessed.

6.2.2 Payment Default Thresholds

Eight of the respondents agreed that Payment Default Thresholds should be introduced to minimise administrative effort and that these should be set out within a new BSCP and ELEXON/FAA working instructions.

- However one respondent didn't agree on the grounds that the relaxation of timescales described above should reduce the number of defaults. Therefore when a default does occur, this will be genuine and should be investigated regardless of the size.
- The other party to disagree stated that there should be a de minimus level rather than several thresholds. For example, all defaults over [£50] would be progressed via the current procedure. They believe that providing one business day for a defaulting party to pay prior to the issue of a default notice should be sufficient for all parties, regardless of the size of the default. They also consider the suggested threshold of £50,000 to be excessive.
- One respondent agreed that Payment Default Thresholds should be introduced, however the largest defaults should be escalated on D+2 rather than D+1 which was proposed in P39.

- Finally one respondent suggested that consideration should be given to the set off rules in paragraph N2.6.1 of the Code which limits the transfer of funds to a party if they have an outstanding default.

Each of these points can be discussed further during the Assessment Procedure.

6.2.3 Letters of Credit

The consultation noted that the new procedures should take into account the time it takes to call on Letters of Credit. It was suggested that the exact process would be discussed as part of the Assessment Procedure, however respondents were invited to express any views that they wished to be included in the discussion.

Respondents agreed that the entire process should be reviewed as part of the Assessment Procedure. It was noted that:

- Care should be taken not to give undue advantage to parties providing Letters of Credit rather than cash.
- Any additional costs should be allocated to those causing them.
- Letters of Credit should not be called on without the relevant party being given advance notification and an opportunity to remedy the position.

6.2.4 Payment transfers

All respondents agreed that it is not appropriate for charges relating to payment transfers to be incurred by the BSCCo and, in turn, smeared across all parties. Therefore a specific statement in the Code would be beneficial to clarify this issue.

6.2.5 Retrospective versus Prospective

Finally the consultation proposed that the modification would be implemented after the Authority's decision rather than retrospectively. All respondents agreed that the modification should be prospective, not retrospective. However one respondent noted that any money outstanding at implementation should be subject to the new thresholds and timescales.

ANNEX 1 – MODIFICATION PROPOSAL P39

Modification Proposal	MP No: P39 <i>(mandatory by BSCCo)</i>
Title of Modification Proposal <i>(mandatory by proposer):</i> Improvements To The Administration Of The Payment Default Process	
Submission Date <i>(mandatory by proposer):</i>	
<p>Description of Proposed Modification <i>(mandatory by proposer):</i></p> <p>The proposal aims to remove inconsistencies between operating practices and the payment default procedures documented in the Code. There are four main changes that are proposed:</p> <p>The timescales relating to the transfer of funds (section N8.2) should be modified to take into account the delay which arises from the processing of these funds by the relevant banks.</p> <p>Default thresholds should be introduced, whereby insignificant default amounts are treated differently to significant amounts e.g. amounts under £1,000 are not escalated to the Panel within the same timescales as defaults of £1,000,000.</p> <p>Credit Cover in the form of a Letter of Credit is not available immediately, therefore the Code should include provisions for Letters of Credit to be called on the Payment Date (if payment hasn't been received) so that the funds are available on D+1.</p> <p>An explicit statement should be added to the Code stating that BSC Parties should use a UK bank, or they will be liable for the charge which is applied to the transfer of money to a foreign bank.</p>	
<p>Description of Issue or Defect that Modification Proposal Seeks to Address <i>(mandatory by proposer):</i></p> <p>Section N8.1.1 of the Code states that parties should ensure payment is credited to the Collection Account by 12:00 on the relevant Payment Date. In practice, Trading Parties make instructions for payments on the day that they are due. However, these payments take time to process and thus while an instruction can be made in the morning, payment is usually received in the afternoon. In any event payments cannot be made after approximately 17:00 for Barclays Bank and 15:00 for other collection banks.</p> <p>Sections N8.2.1/2 of the Code state that the FAA shall find out whether all required amounts have been credited to the Collection Account by 13:00 and that these are then remitted to the Clearing Account by 13:30 on the relevant Payment Date to allow payment to BSC Creditors. In practice this is conducted after the payment deadlines for the relevant banks.</p> <p>The Code states that Letters of Credit must be capable of being called upon immediately. However in practice there are several manual steps involved, including an authorised person from the FAA travelling to Canary Wharf to sign for the credit at Barclays Bank. Therefore once a Letter of Credit is called on there is a finite amount of time before the funds are available (e.g. if the decision is made after 15:00, it is unlikely that funds will be available until the next Business Day). Furthermore the Code does not allow for Letters of Credit to be called on the Payment Date if there is money available in the BSCCo's Borrowing Account. Thus Letters of Credit will only be called when the Borrowing Account can not be used, in which event there will probably be a delay of one Business Day before credit is available.</p> <p>There are some parties with only small outstanding balances, whilst others can be quite significant. Under the Code there is no minimum threshold, therefore if a party fails to transfer the required amount on the relevant Payment Date, ELEXON can issue a Payment Default notice. This Payment Default should be escalated to the Panel if the party doesn't pay within 3 days of the notice being issued. This could mean a lot of work is carried out in order to present to the Panel a default for a small amount e.g. £10.</p>	

Modification Proposal	MP No: P39 <i>(mandatory by BSCCo)</i>
<p>A separate issue is that a charge is made when crediting foreign accounts. Foreign parties therefore will not receive the full amount of any credit if they don't use a UK bank. The Code does not explicitly say whether the relevant party or the BSC Clearer should pay these charges. In the absence of an explicit statement, it may be that some parties are expecting to be able to claim these charges back from BSC Clearer.</p>	
<p>Impact on Code <i>(optional by proposer):</i></p> <p>This proposal will require significant changes to Section N8 and N9 of the Code which relate to the Payment Procedure and Payment Default respectively.</p>	
<p>Impact on Core Industry Documents <i>(optional by proposer):</i></p> <p>There is currently no BSCP to cover Payment Default. A new BSCP describing this procedure will be proposed for implementation in parallel with this Modification.</p>	
<p>Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties <i>(optional by proposer):</i></p> <p>The proposed change is mainly procedural, therefore it is not envisaged that there will be an impact on any systems. However there may be changes to the payment processes used by parties to enable revised timescales in the Code to be met.</p>	
<p>Impact on other Configurable Items <i>(optional by proposer):</i></p>	
<p>Justification for Proposed Modification with Reference to Applicable BSC Objectives <i>(mandatory by proposer):</i></p> <p>The Modification Proposal has been raised by the BSC Panel on the recommendation by BSCCo, in accordance with section F2.1.1 (d) This proposal would better facilitate the objective in Condition 7A (3) (d) of the Transmission Licence, Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.</p> <p>The proposal will promote efficiency by introducing default thresholds so that insignificant default amounts are not progressed to the Panel as quickly as significant amounts.</p> <p>The proposal will also modify the timescales relating to payment of Trading Charges to account for the time delay in processing funds. This will allow the operating practices to reflect the process set out in the Code.</p>	
<p>Details of Proposer:</p> <p style="padding-left: 40px;">Name: BSC Panel</p> <p style="padding-left: 40px;">Organisation:</p> <p style="padding-left: 40px;">Telephone Number:</p> <p style="padding-left: 40px;">Email Address:</p>	

Modification Proposal	MP No: P39 <i>(mandatory by BSCCo)</i>
Details of Proposer's Representative: Name: Sarah Parsons Organisation: ELEXON Telephone Number: 0207 380 4321 Email Address: sarah.parsons@elexon.co.uk	
Details of Representative's Alternate: Name: Jason Brogden Organisation: ELEXON Telephone Number: 0207 380 4312 Email Address: jason.brogden@elexon.co.uk	
Attachments: NO If Yes, Title and No. of Pages of Each Attachment:	

ANNEX 2 – REPRESENTATIONS MADE BY PARTIES

See the associated document 'P39_Representations made from Parties' for the full consultation responses.