

July 2001

**Modification Proposal P2 - Initial  
Views of the Credit Modification  
Group on Alternative Modification  
Proposals**

<b>Document Reference</b>	005ABU
<b>Version no.</b>	1.0
<b>Issue</b>	Final
<b>Date of Issue</b>	3 July 2001
<b>Reason for Issue</b>	Consultation
<b>Author</b>	John Lucas

## I DOCUMENT CONTROL

### a Authorities

Version	Date	Author	Signature	Change Reference
0.1	2/7/01	John Lucas		
1.0	3/7/01	John Lucas		

Version	Date	Reviewer	Signature	Responsibility
0.1	2/7/01	Sarah Parsons		

Version	Date	Approver	Signature	Responsibility
1.0	3/7/01	John Williamson		

Version	Date	Authorisation	Signature	Responsibility

### b Distribution

Name	Organisation

### c Change History

Version 0.1 issued for initial review.

Version 1.0 (incorporating review comments) issued for industry consultation.

### d Changes Forecast

None.

### e Related Documents

- Reference 1      Modification Proposal P2 - Revision of the Methodology for Assessing Credit Indebtedness
- Reference 2      Definition Report – Modification Proposal P2 – Revision of the Methodology for Assessing Credit Indebtedness, 24<sup>th</sup> May 2001 (MDR02)
- Reference 3      MP2 Requirements Specification – Revision of the Methodology for Assessing Credit Indebtedness, 28<sup>th</sup> June 2001

### f Intellectual Property Rights and Copyright

This document contains materials the copyright and other intellectual property rights in which are vested in ELEXON Limited or which appear with the consent of the copyright owner. These materials are made available for you to review and to copy for the purposes of the establishment, operation or participation in electricity trading arrangements in Great Britain under the BSC and the consultation process now taking place in relation thereto. All other commercial use is prohibited. Unless you are a person having an interest in electricity trading in Great Britain under the BSC you are not permitted to view, download,

modify, copy, distribute, transmit, store, reproduce or otherwise use, publish, licence, transfer, sell or create derivative works (in whatever format) from this document or any information obtained from this document otherwise than for personal academic or other non-commercial purposes. All copyright and other proprietary notices contained in the original material must be retained on any copy that you make. All other rights of the copyright owner not expressly dealt with above are reserved.

## II CONTENTS TABLE

<b>I</b>	<b>Document Control.....</b>	<b>2</b>
a	Authorities.....	2
b	Distribution.....	2
c	Change History.....	2
d	Changes Forecast .....	2
e	Related Documents .....	2
f	Intellectual Property Rights and Copyright.....	2
<b>II</b>	<b>Contents Table .....</b>	<b>4</b>
<b>1</b>	<b>Introduction.....</b>	<b>5</b>
1.1	Background .....	5
1.2	Purpose and Structure of Document.....	6
1.3	Glossary.....	6
<b>2</b>	<b>Alternative Modification Proposals .....</b>	<b>8</b>
2.1	Alternative Proposal A .....	8
2.1.1	Further Proposed Quantitative Analysis .....	9
2.2	Alternative Proposal B.....	9
2.2.1	Further Proposed Quantitative Analysis .....	9
2.3	Alternative Proposal C .....	10
2.3.1	Further Proposed Quantitative Analysis .....	10
2.4	Alternative Proposal D.....	10
2.4.1	Further Proposed Quantitative Analysis .....	11
2.5	Alternative Proposal E.....	11
2.5.1	Further Proposed Quantitative Analysis .....	12
<b>3</b>	<b>Issues on which Views are Sought .....</b>	<b>14</b>
3.1	Alternative Modification Proposals.....	14
3.2	Additional Reporting.....	15
3.3	Use of GC and DC under the Alternative Modification Proposal.....	15

## 1 INTRODUCTION

### 1.1 Background

Modification Proposal P2 (Reference 1) was submitted by British Gas on 27th March 2001, and proposes that the calculation of indebtedness for credit-checking purposes should be enhanced to use actual prices and metered volumes. The proposal states that this would protect Parties from the expense of having to post inappropriate levels of credit cover, and also the risk of a defaulting Party having unsecured settlement liabilities.

The BSC Panel meeting on 5<sup>th</sup> April 2001 agreed that Modification Proposal P2 should be submitted to the Definition Procedure (as defined in section F2.5 of the Balancing and Settlement Code). This Definition Procedure was carried out by the Credit Modification Group, and resulted in the presentation of a Definition Report (Reference 2) to the BSC Panel meeting on 31<sup>st</sup> May 2001. This report estimated the materiality of the issues raised by Modification Proposal P2, and identified a number of Alternative Modification Proposals that might also address those issues.

At the meeting on 31<sup>st</sup> May, the BSC Panel approved the Definition Report, and noted the findings of the Modification Group, namely that Trading Parties are being exposed to significant risks and costs as a result of inaccuracies in the current credit-checking methodology. In addition:

- BSC Panel members recommended that the solutions be pared down to a maximum of two, then consulted on within the industry.
- The BSC Panel authorised the Modification Group to undertake further consultation on the Modification Proposal during the Assessment Procedure.

On 20<sup>th</sup> June 2001, the Credit Modification Group met to consider further the Alternative Modification Proposals identified in the Definition Report, and agreed that two solutions should be taken forward for consultation and assessment:

- Modification Proposal P2 itself. Under this option, indebtedness for Settlement Periods for which the Interim Information run has taken place should take into account all Trading Charges (i.e. energy imbalance charges, information imbalance charges, BM payments, Non-Delivery charges and Residual Cashflow Reallocation Cashflow), based on actual CVA metered volumes, and estimated SVA metered volumes. For Settlement Periods for which the Interim Information run has not taken place, indebtedness should be calculated as currently.
- An Alternative Modification Proposal. Under this option, indebtedness for Settlement Periods for which the Interim Information run has taken place should be calculated in the same way as for Modification Proposal P2. However, for Settlement Periods for which the Interim Information run has not taken place, indebtedness should be calculated using average metered volumes from SAA, rather than CALF-based estimates as currently.

***Note that the Alternative Modification Proposal issued for assessment was developed by the Modification Group at the meeting on 20<sup>th</sup> June 2001, and is not one of those described in the P2 Definition Report (Reference 2), or section 2 of this document. Full details of the Alternative Modification Proposal (and P2***

***itself) can be found in the MP2 Requirements Specification (Reference 3), which is being circulated to Parties with this document, and should be read in conjunction with it.***

Note also that a number of parties have raised concerns with ELEXON that the Residual Cashflow Reallocation Cashflow (RCRC) values reported in the Interim Information run are extremely inaccurate, and that therefore the use of these values in calculating indebtedness is inappropriate. The intention is that this should not be an issue, as P2 will amend the SAA Interim Information run to estimate metered volumes for Supplier BM Units, and hence to calculate accurate RCRC values<sup>1</sup>. A detailed quantitative analysis of any residual inaccuracy in the Interim Information RCRC values under P2 will be presented by ELEXON to the Modification Group meeting on 13<sup>th</sup> July 2001.

## **1.2 Purpose and Structure of Document**

The purpose of this document is to:

- Describe the reasons for the Modification Group's decision on which two solutions to take forward to consultation and assessment.
- Seek the views of Parties on which of the two solutions better facilitates achievement of the Applicable BSC Objectives, and other related issues.

This document will be issued for consultation, and any consultation responses reflected in the Assessment Report issued by the Modification Group to the BSC Panel.

The document is structured as follows:

- Section 2 of this document describes the views expressed at the Modification Group meeting on 20<sup>th</sup> June 2001 on each of the Alternative Modification Proposals listed in the P2 Definition Report (Reference 2). It is divided into five sub-sections, corresponding to the five Alternative Proposals identified in the Definition Report.
- Section 3 lists a number of issues on which views are specifically requested from respondents to the consultation.

## **1.3 Glossary**

The following acronyms have been used throughout this document:

BMCAEC	BM Unit Credit Assessment Export Capability
BMCAIC	BM Unit Credit Assessment Import Capability
BSC	Balancing and Settlement Code
CALF	Credit Assessment Load Factor
CAP	Credit Assessment Price
CVA	Central Volume Allocation
DC	Demand Capacity

---

<sup>1</sup> A side-effect of P2 (or the Alternative Modification Proposal) is therefore that the accuracy of the imbalance charges and RCRC values reported by the Interim Information run will increase, giving Trading Parties a clearer indication at the Interim Information stage of the Trading Charges for which they will be liable at Initial Settlement.

ECVAA	Energy Contract Volume Aggregation Agent
ECVN	Energy Contract Volume Notification
FPN	Final Physical Notification
GC	Generation Capacity
MP2	Modification Proposal P2
MVRN	Metered Volume Reallocation Notification
QME	Period Expected Metered Volume
RCRC	Residual Cashflow Reallocation Cashflow
SAA	Settlement Administration Agent
SVA	Supplier Volume Allocation
URS	User Requirements Specification

## 2 ALTERNATIVE MODIFICATION PROPOSALS

This section of the document describes the views expressed at the Modification Group meeting on 20<sup>th</sup> June 2001 on each of the Alternative Modification Proposals listed in the P2 Definition Report (Reference 2). It is structured as follows:

- Section 2.1 describes the reasons why the Modification Group felt it appropriate not to progress Alternative Proposal A (as defined in the Definition Report), but did support taking forward to impact assessment and consultation a variant that includes some aspects of Alternative Proposal A.
- Section 2.2 describes the reasons why the Modification Group felt it appropriate not to progress Alternative Proposal B (as defined in the Definition Report).
- Section 2.3 describes the reasons why the Modification Group felt it appropriate not to progress Alternative Proposal C (as defined in the Definition Report).
- Section 2.4 describes the reasons why the Modification Group felt it appropriate not to progress Alternative Proposal D (as defined in the Definition Report), but did support taking forward to impact assessment and consultation a variant that includes some aspects of Alternative Proposal D.
- Section 2.5 describes the reasons why the Modification Group felt it appropriate not to progress Alternative Proposal E (as defined in the Definition Report).

### 2.1 Alternative Proposal A

The P2 Definition Report (Reference 2) describes Alternative Modification A as follows:

*Alternative Proposal A is similar to Modification Proposal P2, but avoids the need to continue using BMCAEC or BMCAIC in the period prior to CVA metered volumes becoming available. Instead the credit checking process would calculate the total indebtedness for that portion of the 29-day credit-checking period for which CVA metered volumes were available, and then 'scale up' the value to produce an estimate of indebtedness for the entire 29-day period.*

The Modification Group meeting on 20<sup>th</sup> June took the view that this Alternative Proposal would not facilitate achievement of the Applicable BSC Objectives, because the estimate of indebtedness for the period prior to the Interim Information run would no longer be based on actual ECVN and MVRN data. As a result, the credit-checking process would no longer meet the objective of protecting Parties from 'distressed selling' by a Party about to go into default.

However, the Modification Group did believe it was desirable to consider an Alternative Modification Proposal which used more accurate data in the period prior to the Interim Information run. In particular, the indebtedness calculation:

- Should be based on actual ECVN and MVRN data, as currently, in order to protect Parties against 'distressed selling';
- Should not be based on actual price data, in order to avoid any unpredictable increase in a Party's indebtedness outside of banking hours, when they would be unable to provide additional credit cover; and



- Should be based on actual metered volumes.

The Alternative Modification Proposal described in section 4 of the MP2 Requirements Specification (Reference 3) meets these criteria.

### 2.1.1 Further Proposed Quantitative Analysis

Prior to the production of the Assessment Report, ELEXON will provide a quantitative analysis of the additional benefit (i.e. reduced cost and/or risk) of this Alternative Modification Proposal, relative to Modification Proposal P2 itself.

## 2.2 Alternative Proposal B

The P2 Definition Report (Reference 2) describes Alternative Modification B as follows:

*Alternative Proposal B is the same as Modification Proposal P2, but using a simpler method to estimate SVA metered volumes (once CVA metered volumes become available). Variants on this alternative would include the following:*

- *Apportioning GSP Group Take between Supplier BM Units in proportion to their Demand Capacity (DC) values. (B1)*
- *Apportioning GSP Group Take between Supplier BM Units in proportion to market share data held by ELEXON. (B2)*
- *Estimating SVA meter volumes on the basis of CALF and GC/DC, as under the current methodology (i.e. continue to use CAP and CALF for SVA meter volumes for the entire 29 day period). (B3)*

The Modification Group meeting on 20<sup>th</sup> June did not see that any of these alternatives had a clear advantage over Modification Proposal P2 itself. In particular:

- Any of the three options is likely to be significantly less accurate than Modification Proposal P2 itself, in that the estimate of metered volume would be based on market share estimates that would remain constant over an entire Season (or month, in the case of B2). The calculation of indebtedness would therefore be unable to take into account variations in market share within a Season (or month, in the case of B2).
- Options B1 and B2 would in addition probably be more complex to implement than Modification Proposal P2 itself, as either one would require a new interface to provide SAA with the data required to estimate metered volumes for Supplier BM Units.

For these reasons, and in light of the recommendation of BSC Panel Members that they consult on no more than two solutions, the Group decided not to progress any of these options.

### 2.2.1 Further Proposed Quantitative Analysis

Prior to the production of the Assessment Report, ELEXON will provide a quantitative analysis of the relative accuracy of these different methods of estimating SVA metered volumes.

## 2.3 Alternative Proposal C

The P2 Definition Report (Reference 2) describes Alternative Modification C as follows:

*Alternative Proposal C is to continue using the current methodology (based on CAP, CALF and GC/DC), but increase its accuracy, through more sophisticated techniques for setting the values of CAP, CALF and/or GC/DC. Possible improvements would include:*

- *Increasing the frequency of updates to Credit Assessment Load Factor (CALF), in order to obtain more accurate estimates of metered volumes. (At present CALF values are based on historical data from the previous year and revised at the start of every BSC Season.) However, it should be noted that the CAP/CALF Working Group looked, prior to Go-live, at the possibility of generating CALF on a more regular basis, but concluded that this would not alter the accuracy of CALF values enough to justify the administrative cost of more frequent updates. (C1)*
- *Introducing an automated system for recalculating CAP values on a regular basis, in order to achieve more accurate estimates of indebtedness. Such a calculation might, for example, seek to set CAP to ensure that the total indebtedness (summed across all Parties) matched the actual indebtedness. It could not however ensure that the actual indebtedness for individual Parties was correct. (Nor could it ensure that the total credit cover equalled total indebtedness at any given time.) (C2)*
- *Introducing a mechanism to allow GC/DC values to be adjusted mid-season, in order to obtain more accurate estimates of metered volumes. (C3)*
- *Resolving anomalies in the calculation of BMCAIC and BMCAEC. The logic for calculating these values (in Section M1.6.1 of the BSC) currently depends upon whether the BM Unit is a Production or Consumption BM Unit, which is appropriate for most BM Units, but can lead to anomalous estimates of metered consumption for pumped storage units, and for Exempt Export BM Units which the Lead Party has elected to treat as Consumption in accordance with Section K3.5.5. (C4)*

The Modification Group meeting on 20<sup>th</sup> June took the view that these proposals were better regarded as separate Modification Proposals which Parties are free to raise if they feel it appropriate, rather than Alternative Modification Proposals to P2. They therefore proposed not to progress them further within the Assessment Procedure for Modification Proposal P2.

### 2.3.1 Further Proposed Quantitative Analysis

No further analysis of these options is proposed within the P2 Assessment Procedure.

## 2.4 Alternative Proposal D

The P2 Definition Report (Reference 2) describes Alternative Modification D as follows:

*Alternative Proposal D is a partial implementation of Modification Proposal P2, in which indebtedness is calculated using actual metered volumes, but not actual prices.*

*Variants on this alternative would include the following:*

- *Applying a single Credit Assessment Price to actual CVA metered volumes, but continuing to estimate SVA metered volumes using CALF and GC/DC values as under the current methodology. (D1)*
- *Applying a single Credit Assessment Price to actual CVA metered volumes, and to an appropriate estimate of SVA metered volumes. This estimate of metered volumes could either be the “best estimate”, as under Modification Proposal P2, or one of the simplified estimates described above under Alternative Proposal B. (D2)*
- *A further refinement on option D1 or D2 would be to use different Credit Assessment Price values for positive and negative imbalances i.e. dual CAP prices to reflect the dual energy imbalance prices. (D3, D4)*

The Modification Group meeting on 20<sup>th</sup> June took the view that using any of these four options to calculate indebtedness for periods after the Initial Information run was unlikely better to facilitate the Applicable BSC Objectives, for the following reasons:

- Although the four sub-options are conceptually simpler than Modification Proposal P2 (in that not all the Trading Charges have to be calculated), they would in practice be more complex to implement, in that new processes would be required to perform the calculations. In contrast, Modification Proposal P2 itself is relatively simple to implement, because the complex calculations of indebtedness required are the same as those already performed by the SAA system, and therefore no new calculation process is required.
- As none of the four options includes all the Trading Charges calculated by SAA, they are all less accurate than Modification Proposal P2 itself.

In summary, then, any of the four options would be more expensive and less accurate than Modification Proposal P2 itself, and therefore cannot better achieve the Applicable BSC Objectives.

It should be noted, however, that the above arguments do not apply to the calculation of indebtedness prior to the Initial Information run. The Modification Group therefore discussed separately the possibility of using one of these four methods for this purpose. The results of this discussion are reflected in the Alternative Modification Proposal included in the Requirements Specification (Reference 3), in that this can be regarded as a variant of option D2, applying only to those periods prior to the Interim Information run.

#### **2.4.1 Further Proposed Quantitative Analysis**

Prior to the production of the Assessment Report, ELEXON will provide a quantitative analysis of the relative accuracy of the four different variants of Option D (focussing particularly on Option D2, which forms the basis of the Alternative Modification Proposal issued for impact assessment).

## **2.5 Alternative Proposal E**

The P2 Definition Report (Reference 2) describes Alternative Modification E as follows:

*Alternative Proposal E is to use Final Physical Notification (FPN) values (or, more likely, QME values) as an estimate of metered volumes, as suggested in one of the responses*

to the Initial Written Assessment. Variants on this alternative would include the following:

- Using FPN/QME values only until CVA metered volumes become available, and then using CVA metered volumes and a “best estimate” of SVA metered volumes, as in Modification Proposal P2. (E1)
- Using FPN/QME values until CVA metered volumes become available, and also after that point for SVA metered volumes. (E2)
- Using FPN/QME values throughout the credit-checking process in place of metered volumes. (E3)

It is noted that FPN data does not exist for all BM Units, therefore it would still be necessary to determine metered volumes for those BM Units via an alternative route (i.e. other than using FPN data). This is true of options E1, E2 and E3. Sub-options include:

- Estimating the metered volumes using CALF and GC/DC as per the existing methodology (E1,2,3a)
- Placing an obligation on parties to submit FPN values for all BM Units (E1,2,3 b)
- Scale up the metered volumes determined for such BM Units in the period for which CVA metered data is available (E1,2,3 c).

The Modification Group meeting on 20<sup>th</sup> June took the view that none of options E1, E2 and E3 was likely to be better than P2 itself at facilitating achievement of the Applicable BSC Objectives, for the following reasons:

- Option E1 is to use FPN data in the period prior to CVA metered volumes becoming available. Given that Panel members had recommended that they restrict the consultation to two solutions, and that this option promised to be significantly more complex<sup>2</sup> than using ‘scaled up’ metered volumes, the Group decided to progress the option of ‘scaled up’ metered volumes instead.
- Option E2 is the same as option E1, but with the additional refinement of continuing to use FPN data for SVA metered volumes throughout the 29-day credit period. This option would involve both ECVA and SAA in the complexity of handling FPN values, and was felt to offer little added benefit in return.
- Option E3 would be significantly less accurate than Modification Proposal P2, and also more complex to implement.

For these reasons, and in light of the recommendation of BSC Panel Members that they consult on no more than two solutions, the Group decided not to progress any of these options.

### 2.5.1 Further Proposed Quantitative Analysis

Prior to the production of the Assessment Report, ELEXON will analyse the Information Imbalance volumes reported by SAA, in order to assess the accuracy of Final Physical Notification data provided by Parties. In particular, this analysis will seek to confirm

---

<sup>2</sup> The additional complexity arising from the need for a new interface to provide ECVA with FPN data, and the need to allow for BM Units without FPN data.

whether use of FPN data in the period prior to the Interim Information run would be more or less accurate than use of 'scaled up' metered volumes.

### 3 ISSUES ON WHICH VIEWS ARE SOUGHT

This section of the document lists a number of issues related to Modification Proposal P2 on which the views of parties are invited:

- Section 3.1 invites views on which of the Alternative Modification Proposals considered by the Modification Group best facilitates achievement of the Applicable BSC Objectives.
- Section 3.2 invites views on additional reporting under P2 (as described in section 2.4 of the P2 Requirements Specification, Reference 3).
- Section 3.3 invites views on the use of GC and DC under the Alternative Modification Proposal (as described in section 4.3 of the P2 Requirements Specification, Reference 3).

#### 3.1 Alternative Modification Proposals

In addition to any general comments on the content of section 2 of this document, views are invited on the following issues:

- Are there any specific issues which you feel the Modification Group should take into account when deciding whether or not to recommend to the Panel Modification Proposal P2 (as described in sections 2.2 and 3 of the attached document 016AAR). For example, do you believe that any specific feature of this Modification Proposal either facilitates, or fails to facilitate, achievement of the Applicable BSC Objectives?
- Are there any specific issues which you feel the Modification Group should take into account when deciding whether or not to recommend to the Panel the Alternative Modification Proposal described in sections 2.3 and 4 of the attached document 016AAR. For example, do you believe that any specific feature of this Modification Proposal either facilitates, or fails to facilitate, achievement of the Applicable BSC Objectives?
- To the extent that you feel able to express a view in the absence of any assessment of costs, do you prefer:
  - i) Modification Proposal P2 (as described in sections 2.2 and 3 of the attached document 016AAR);
  - ii) The Alternative Modification Proposal (as described in sections 2.3 and 4 of the attached document 016AAR);
  - iii) The existing methodology for assessing credit indebtedness (i.e. no change)?
- Are there any other Alternative Modification Proposals that would, in your view, better achieve the Applicable BSC Objectives? (Note that section 2 of this document describes the preliminary views of the Modification Group on why a number of the Alternative Modification Proposals described in the P2 Definition Report would not facilitate achievement of these Objectives.)

### 3.2 Additional Reporting

Views are also invited on the following questions (which relate to section 2.4 of the Requirements Specification, Reference 3):

- Do you believe that additional reporting of the data used to calculate indebtedness would be required, should P2 or the Alternative Modification Proposal be implemented?
- If so, what additional data items would be required?

### 3.3 Use of GC and DC under the Alternative Modification Proposal

As described in section 4.3 of the Requirements Specification (Reference 3), one of the side-effects of the Alternative Modification Proposal is that data items  $BMCAIC_i$ ,  $BMCAEC_i$ ,  $GC_i$ ,  $DC_i$  and  $CALF_i$  would no longer be required. It would therefore be proposed to remove data items  $BMCAIC_i$ ,  $BMCAEC_i$ , and  $CALF_i$  from the BSC, should this Alternative Modification Proposal be approved. Potentially the same argument applies to data items  $GC_i$  and  $DC_i$ . However, it is recognised that these data items may be used for other purposes (e.g. assessing whether BM Units are above the *de minimis* level, and Use of System charging). Views are therefore also invited on the following question:

- In the event that the Modification Group recommended a solution to the issues raised by Modification Proposal P2 that removed the need to use values of Generation Capacity (GC) and Demand Capacity (DC) in credit checking, would you support the removal of these data items from the BSC, or do you believe that they should be retained for other purposes?