Stage 04: Final 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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Contents

1 Summary 3

2 Why Change? 4

3 Solution and Implementation 5

4 Impacts and Costs 6

5 The Case for Change 7

6 Panel's Discussions 9

7 Report Phase Consultation Responses 10

8 Panel's Final Views and Recommendations 11

9 Further Information 12

Attachment A: Detailed Assessment

Attachment B: Proposed Modification Legal Text

Attachment C: Alternative Modification Legal Text

About This Document:

This document is a Final Modification Report, which ELEXON has submitted to the Authority on the Panel's behalf. The Authority will decide whether or not it agrees with the Panel's recommendations in this report, and will issue a decision letter to either approve or reject the change.

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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1 Summary

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 unanimously recommends 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 respondents to both the Assessment and Report Phase Consultations.

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2 Why Change?

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 excludes the Payment Date for the current Reconciliation Run	Interest calculation period includes 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.

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.

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

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3 Solution and Implementation

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 details.

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 or 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.

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

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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.

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

See Sections 2.6, 3 and 4 in Attachment A

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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.

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

[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.

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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.

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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.

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

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7 Report Phase Consultation Responses

ELEXON consulted on the Panel's initial recommendations during the Report Phase.

The following table summarises the industry responses. You can download the full individual responses here.

	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

Did respondents support the Panel's recommendations?

Respondents unanimously agreed with the Panel's initial recommendations. As the same Parties responded to both the Report and Assessment Consultations, Report Phase respondents generally referred back to their previous, more detailed arguments.

All respondents agreed that:

- Both the Proposed and Alternative Modifications 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, although one respondent disagreed with the Panel's initial view that any benefits under Applicable BSC Objective (c) are of second-order effect.

Applicable BSC Objective (c)

The respondent considered that the current position of inconsistency cannot be maintained – and that either the Code will be amended or the FAA systems changed, depending on what the Authority decides. They therefore believed that arguments under Objective (c) are not second-order, as approving P235 will enforce the appropriate methodology and deliver the benefits of using that methodology (which are that the appropriate cashflows are not changed).

The respondent also noted that some of the arguments under Objective (d) relate to implications which will arise if P235 is rejected, for example avoiding costs to align the FAA systems with the Code. They questioned whether avoiding negative implications could be considered second-order for Objective (c) but not for Objective (d).

What were Report Phase respondents' views?

Respondents unanimously supported the Panel's initial recommendations, and no new arguments were raised

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8 Panel's Final Views and Recommendations

What are the Panel's final views?

The Panel considered the Report Phase Consultation responses and the Draft Modification Report at its meeting on 11 June 2009.

The Panel:

- Noted that there were no new arguments from respondents, and that all respondents supported the legal text with no suggested changes;
- Continues to unanimously support the Alternative Modification as the best solution;
- Supports the view of the Group and respondents that the specific circumstances of P235 which require a retrospective implementation are exceptional, and that this should not be taken to set a general precedent in favour of retrospective changes.

Panel Members noted the views of respondents that P235 would deliver benefits under Applicable BSC Objective (c). However, Members continue to rely either entirely or primarily on the arguments around **Applicable BSC Objective (d)**.

A Panel Member commented that approving P235 could not be said to deliver improved competition because it simply formalises the existing interest calculation – so how can **maintaining** the current calculation be **better** than the current calculation? They believed that, at the most, it avoids some anti-competitive effects which will occur if P235 is rejected and the FAA systems have to be changed to match the Code. Another Member confirmed their view that these are second-order benefits compared with the improved efficiency which P235 will deliver. A Member stated that they continue to rely wholly on the original efficiency arguments under which the Panel raised P235.

The Panel therefore unanimously recommends to the Authority:

- That Proposed Modification P235 **should not** be made;
- That Alternative Modification P235 **should** be made;
- A **prospective Calendar Day** Implementation Date for Proposed Modification P235 of 2 Working Days after an Authority decision;
- A **retrospective** Implementation Date for Alternative Modification P235 of 27 March 2001 (NETA Go-Live);
- The legal text for Proposed Modification P235 (as contained in Attachment B); and
- The legal text for Alternative Modification P235 (as contained in Attachment C).

Recommendation

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

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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 Legal Text

Attachment C: Alternative Modification Legal Text

See these attachments for copies of the legal text 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.

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