

What stage is this document in the process?

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Stage 04: Draft Modification Report

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.

-  Initially, 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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Attachment A: Detailed Assessment

Attachment B: Proposed Modification Draft Legal Text

Attachment C: Alternative Modification Draft Legal Text

About This Document:

This document is a Draft Modification Report, which ELEXON is issuing for a Report Phase Consultation.

The consultation seeks your views on the Panel's initial recommendation as to whether the change should be made, including its suggested implementation approach and legal text. This is the final opportunity to comment on P235 before it is submitted to the Authority.

Please use the response form which you can download from ELEXON's website [here](#).

The Panel will consider your response at its meeting on 11 June 2009, when it will agree its final recommendations. ELEXON will then submit a Final Modification Report to the Authority.



Any questions?

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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's initial unanimous recommendation is 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 Assessment Consultation respondents.



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.

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 <u>excludes</u> the Payment Date for the current Reconciliation Run	Interest calculation period <u>includes</u> 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.

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



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

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 detail.

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 and the Alternative Modification.

Minor changes have been made to this text following the Assessment Consultation. These changes reflect the different implementation approaches for the two solutions and incorporate two additional points of clarity.

You can find a more detailed description of the changes in Section 7 of Attachment A.



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

See Sections 2.6, 3 and 4 in Attachment A

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.



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

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.

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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](#).

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.

**What is the Panel's view?**

The Panel supports both the Proposed and Alternative Modifications, but believes the retrospective Alternative is best overall

Does the Panel agree with the Group's views?

The Panel **unanimously** agrees 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 is therefore that the Alternative Modification should be approved.

In its views, the Panel relies primarily on the argument that P235 delivers benefits of increased clarity and transparency. The Panel believes that these benefits better facilitate **Applicable BSC Objective (d)**.

The Panel notes the arguments which the Group and Assessment Consultation respondents have made about benefits to Applicable BSC Objective (c). The Panel considers 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:

- Notes 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 agrees 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 agrees 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.

Legal text

The Panel unanimously agrees with the Group's recommended legal text.

Section 7 of this report contains the Panel's full initial recommendations.

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7 Panel's Initial Recommendations



The Panel initially recommends:

- 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 contained in Attachment B; and
- The legal text for Alternative Modification P235 contained in Attachment C.

Recommendation

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

8 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 Draft Legal Text

Attachment C: Alternative Modification Draft Legal Text

See these attachments for copies of the draft legal text as initially recommended by the Panel.

You can download further P235 documents, including the full industry responses to the Group's previous Assessment Consultation, from ELEXON's website [here](#).

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