



## MODIFICATION REPORT for Modification Proposal P188

### Revision to Credit Default Provisions

Prepared by: ELEXON on behalf of the P188 Modification Group (the 'Group')

<b>Date of issue:</b>	15/08/05	<b>Document reference:</b>	P188MR
<b>Reason for issue:</b>	For Authority Decision	<b>Issue/Version number:</b>	Final/1.0

This document has been distributed in accordance with Section F2.1.10<sup>1</sup> of the Balancing and Settlement Code.

#### RECOMMENDATIONS

Having considered and taken into due account the contents of the draft P188 Modification Report, the Balancing and Settlement Code Panel recommends:

- **that Proposed Modification P188 should be made;**
- **the P188 Implementation Date of 27 June 2006 if an Authority decision is received on or before 21 December 2005, or 8 November 2006 if the Authority decision is received after 21 December 2005 but on or before 3 May 2006; and**
- **the proposed text for modifying the Code, as set out in the Modification Report.**

**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 your establishment or operation of or participation in electricity trading arrangements under the Balancing and Settlement Code ("BSC"). All other commercial use is prohibited. Unless you are a person having an interest in electricity trading in 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.

**Disclaimer** - No representation, warranty or guarantee is made that the information provided is accurate, current or complete. Whilst care is taken in the collection and provision of this information, ELEXON Limited will not be liable for any errors, omissions, misstatements or mistakes in any information or damages resulting from the use of this information or any decision made or action taken in reliance on this information.

<sup>1</sup> The current version of the Balancing and Settlement Code (the 'Code') can be found at <http://www.elexon.co.uk/bscrelateddocs/BSC/default.aspx>

## CONTENTS TABLE

<b>Recommendations .....</b>	<b>1</b>
<b>Summary of Impacted Parties and Documents .....</b>	<b>3</b>
<b>1 Description of Proposed Modification and Assessment Against the Applicable BSC Objectives .....</b>	<b>4</b>
1.1 Modification Proposal .....	4
1.2 Process Followed .....	5
1.3 Proposed Modification .....	6
1.4 Issues Raised by the Proposed Modification .....	6
1.5 Assessment of how the Proposed Modification will Better Facilitate the Applicable BSC Objectives .....	6
1.6 Governance and Regulatory Framework Assessment .....	7
<b>2 Costs .....</b>	<b>8</b>
<b>3 Rationale for Panel's Recommendations .....</b>	<b>9</b>
3.1 Assessment Against the BSC Objectives.....	9
3.2 Implementation Dates .....	10
3.3 Legal Text .....	10
3.4 Other Comments.....	10
<b>4 Impact on BSC Systems and Parties .....</b>	<b>11</b>
4.1 BSCCo .....	11
4.2 BSC Panel.....	11
4.3 BSC Systems.....	11
4.4 Parties and Party Agents .....	11
<b>5 Impact on Code and Documentation .....</b>	<b>12</b>
5.1 Balancing and Settlement Code.....	12
5.2 Code Subsidiary Documents.....	12
<b>6 Summary of Consultations.....</b>	<b>12</b>
6.1 Comments and Views of the Panel .....	13
<b>7 Summary of Transmission Company Analysis .....</b>	<b>13</b>
7.1 Analysis.....	13
7.2 Comments and Views of the Panel .....	14
<b>8 Implementation Approach .....</b>	<b>14</b>
<b>9 Document Control .....</b>	<b>14</b>
9.1 Authorities.....	14
9.2 References .....	14
<b>Annex 1 Legal Text.....</b>	<b>15</b>
<b>Annex 2 Modification Group Details .....</b>	<b>15</b>
<b>Annex 3 Assessment Report .....</b>	<b>16</b>
<b>Annex 4 Clarification of Costs .....</b>	<b>16</b>
<b>Annex 5 Consultation Responses .....</b>	<b>19</b>

## SUMMARY OF IMPACTED PARTIES AND DOCUMENTS

The following parties/documents have been identified as being potentially impacted by Modification Proposal P188.

Parties	Sections of the BSC	Code Subsidiary Documents
Suppliers <input checked="" type="checkbox"/>	A <input type="checkbox"/>	BSC Procedures <input type="checkbox"/>
Generators <input checked="" type="checkbox"/>	B <input type="checkbox"/>	Codes of Practice <input type="checkbox"/>
Licence Exemptable Generators <input checked="" type="checkbox"/>	C <input type="checkbox"/>	BSC Service Descriptions <input checked="" type="checkbox"/>
Transmission Company <input type="checkbox"/>	D <input type="checkbox"/>	Service Lines <input type="checkbox"/>
Interconnector <input checked="" type="checkbox"/>	E <input type="checkbox"/>	Data Catalogues <input type="checkbox"/>
Distribution System Operators <input type="checkbox"/>	F <input type="checkbox"/>	Communication Requirements Documents <input type="checkbox"/>
Non-Physical Traders <input checked="" type="checkbox"/>	G <input type="checkbox"/>	Reporting Catalogue <input type="checkbox"/>
<b>Party Agents</b>	H <input checked="" type="checkbox"/>	MIDS <input type="checkbox"/>
Data Aggregators <input type="checkbox"/>	I <input type="checkbox"/>	<b>Core Industry Documents</b>
Data Collectors <input type="checkbox"/>	J <input type="checkbox"/>	Grid Code <input type="checkbox"/>
Meter Operator Agents <input type="checkbox"/>	K <input type="checkbox"/>	Supplemental Agreements <input type="checkbox"/>
ECVNA <input type="checkbox"/>	L <input type="checkbox"/>	Ancillary Services Agreements <input type="checkbox"/>
MVRNA <input type="checkbox"/>	M <input checked="" type="checkbox"/>	Master Registration Agreement <input type="checkbox"/>
<b>BSC Agents</b>	N <input type="checkbox"/>	Data Transfer Services Agreement <input type="checkbox"/>
SAA <input type="checkbox"/>	O <input type="checkbox"/>	British Grid Systems Agreement <input type="checkbox"/>
FAA <input type="checkbox"/>	P <input type="checkbox"/>	Use of Interconnector Agreement <input type="checkbox"/>
BMRA <input type="checkbox"/>	Q <input type="checkbox"/>	Settlement Agreement for Scotland <input type="checkbox"/>
ECVAA <input checked="" type="checkbox"/>	R <input type="checkbox"/>	Distribution Codes <input type="checkbox"/>
CDCA <input type="checkbox"/>	S <input type="checkbox"/>	Distribution Use of System Agreements <input type="checkbox"/>
TAA <input type="checkbox"/>	T <input type="checkbox"/>	Distribution Connection Agreements <input type="checkbox"/>
CRA <input type="checkbox"/>	U <input type="checkbox"/>	<b>BSCCo</b>
Teleswitch Agent <input type="checkbox"/>	V <input type="checkbox"/>	Internal Working Procedures <input checked="" type="checkbox"/>
SVAA <input type="checkbox"/>	W <input type="checkbox"/>	<b>Other Documents</b>
BSC Auditor <input type="checkbox"/>	X <input type="checkbox"/>	Transmission Licence <input type="checkbox"/>
Profile Administrator <input type="checkbox"/>		System Operator-Transmission Owner Code <input type="checkbox"/>
Certification Agent <input type="checkbox"/>		X = Identified in Report for last Procedure
MIDP <input type="checkbox"/>		N = Newly identified in this Report
<b>Other Agents</b>		
SMRA <input type="checkbox"/>		
Data Transmission Provider <input type="checkbox"/>		

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

## 1.1 Modification Proposal

Modification Proposal P188 'Revision of Credit Default Provisions' ('P188') (Reference 1) was raised on 3 May 2005 by British Gas Trading (the 'Proposer'). P188 was raised as a result of Standing Issue 16 'Credit Default and the Default provisions in Section H of the BSC' (Reference 2). Standing Issue 16 was raised by the Proposer and discussed at a meeting of the Settlement Standing Modification Group (the 'Group') on 26 April 2005.

Under the current trading arrangements, payments to and from Parties in respect of Trading Charges arising on any particular Settlement Day are made, on average, 29 calendar days later. Thus at any given time, Parties may have debts (or be due payments) in respect of Trading Charges incurred, on average, over the previous 29 days. The purpose of Credit Cover is to ensure that, should a Party default on payments, sufficient collateral is available to pay these debts. Energy Indebtedness is calculated in accordance with Section M1.2 of the Code and effectively estimates a Party's liabilities over the 29 day credit window (as an energy volume). Energy Credit Cover is calculated in accordance with Section M2.4 and effectively represents the level of Credit Cover a Party has in place as an energy volume.

Under Section M of the Code, a Trading Party's Credit Cover Percentage (CCP) is calculated by comparison of that Party's Energy Indebtedness with its Energy Credit Cover. A CCP of greater than 100% indicates a Party's estimated liabilities within the 29 day credit window are greater than its level of Credit Cover. Where the CCP of a Party exceeds 80% (Level 1) or 90% (Level 2) for any Settlement Period, the Credit Default provisions specified in Section M3 of the Code apply and as a result a Party may be in Level 1 or Level 2 Credit Default. Where a Party is in Level 1 Credit Default, a notice to such effect is posted on either the Balancing Mechanism Reporting Service (BMRS) or the BSCCo Website. The following provisions apply to a Party in Level 2 Credit Default:

- Notice that the Party is in Level 2 Credit Default will be posted on the BMRS or the BSC Website. Notice of a Level 2 Credit Default is also provided directly to all Parties;
- A Credit Default Refusal Period will apply, during which any Volume Notification submitted that does not decrease the Energy Indebtedness of the Party will be refused in its entirety; and
- A Credit Default Rejection Period will apply, during this period any Volume Notification data already validated will be treated as rejected if it does not have the effect of decreasing the Party's Energy Indebtedness.

Where a Party is in Level 1 Credit Default for a period of 90 continuous days or any intermittent period of 120 out of 180 days or in Level 2 Credit Default for a period of 65 continuous days or any intermittent period of 75 out of 120 days, a Default in relation to that Party occurs in accordance with Section H 3.1 of the Code (a 'Section H Default'). The Panel has discretion to apply a number of provisions to a Defaulting Party under Section H of the Code including the following (this list is not intended to be exhaustive):

- With prior approval of the Authority, removal of the right of the Party to register further Metering Systems and BM Units;
- With prior approval of the Authority, specify that the Party's Plant or apparatus is de-energised;
- Removal of the Party's right to submit Volume Notifications and to reject all previously validated Volume Notifications (whether or not such Notification has the effect of decreasing the Party's Energy Indebtedness); and

- Expel the Party from the Code.

The current Level 2 Credit Default provisions limit a Party's ability to notify contracts which increase its Energy Indebtedness. However, there is no specific requirement to post additional Credit Cover under Level 2 Credit Default provisions; rather, these provisions create an incentive to provide sufficient Credit Cover to avoid the consequence of Level 2 Credit Default.

A situation can occur where a Party is in Level 2 Credit Default and its estimated liabilities within the credit window continue to increase with no further action being required under the Code. In the case of a Supplier, Volume Notifications typically decrease the Party's Energy Indebtedness (since the majority of notifications will be to buy energy) and will not be rejected under the Level 2 Credit Default provisions. However, where the Supplier has not purchased sufficient energy, its Energy Indebtedness will continue to increase. Therefore, a Party may be in Level 2 Credit Default and operating in accordance with the Code, whilst its estimated liabilities increase to a level exceeding its Credit Cover. As such, the Proposer questions whether the current Credit Default provisions are sufficient to mitigate the risk of bad debt in all scenarios.

The Proposer also notes that the time for which a Party can be in Level 1 or 2 Credit Default prior to being in Section H Default exceeds the times taken for liabilities within the 29 day credit window to materialise and questions whether this is appropriate.

P188 proposes to mitigate this risk by introducing an additional set of rules that are implemented in the event of a Trading Party's CCP exceeding 100%. In this instance, once the 100% threshold has been breached, the Trading Party will have 1 Working Day (for example) to lodge sufficient Credit Cover, or to trade out their position to ensure that their Energy Indebtedness is less than 75% (for example). If the Trading Party does not lodge the required level of credit, it will be placed in default in accordance with the provisions within Section H of the Code. Also, during the discussions surrounding Standing Issue 16, the Group suggested that if the same Trading Party breaches the 100% threshold twice within a rolling period of 6 months (for example), then the Trading Party would also be placed in default in accordance with Section H of the Code. The Proposer believes that there may be some merit in introducing this provision relating to persistent breaches. The Proposer believes that some consideration may need to be given to the interaction with the existing Material Doubt provisions, the Query Periods and the Default Cure Periods as defined within Section M of the Code.

## **1.2 Process Followed**

The P188 Initial Written Assessment (IWA) (Reference 3) was presented at the Panel Meeting held on 14 April 2005, where the Panel determined that the Modification Proposal be submitted to a two-month Assessment Procedure conducted by the P188 Modification Group (the 'Group'). The Panel agreed that this Group should comprise of members of the Settlement Standing Modification Group.

The Group convened for the first time on 17 May 2005. An industry consultation (Reference 4) was issued on 8 June 2005 with responses due on 16 June 2005. The responses to this consultation were discussed at the second meeting of the Group on 23 June 2005. The results from impact assessments commissioned to the BSC Agents, BSC Parties, the Transmission Company and the BSCCo were also discussed at this meeting. A number of attendees representing the views of small Parties were present at this second meeting. A teleconference was held on 7 July 2005 to confirm how P188 should be implemented, if approved.

The P188 Assessment Report (annex 3) was presented at the Panel Meeting held on 14 July 2005, where the majority of the Panel supported the Group's recommendation that P188 be approved. The Panel agreed that a draft Modification Report be written and consulted upon, and that the report and associated consultation responses should be presented at the Panel meeting on 11 August 2005. At this meeting, the Panel confirmed its recommendation that P188 should be approved.

### **1.3 Proposed Modification**

Once a Trading Party in Level 2 Credit Default (i.e. the existing Query Period and Cure Periods have expired) breaches 100% CCP, the Party has 2 Working Days (i.e. 48 hours) from the point of breach to lodge sufficient Credit Cover to reduce its CCP to below 90% i.e. exit Level 2 Credit Default. If the Trading Party fails to do this, then it will be in Section H Default. As per the current provisions, the Level 2 Default Cure Period would be discontinued once the 100% CCP breach has occurred.

Trading Parties will also be entered into Section H Default if they breach 100% CCP six times within a rolling period of six months on separate days and as a result of separate instances (i.e. a series of six instances in six months will result in Section H Default). An instance is defined as a single breach of 100%, regardless of how many days it spans e.g. a Trading Party that breaches 100% at 10pm on a notional Day 1 and reduces its CCP to the required level by 10am the next day is deemed to have breached 100% once. An instance that is subsequently shown to be false via the existing 'material doubt' provisions will not count as one of the six instances. To qualify as an instance for a particular series of six, that instance must not occur less than 2 Working Days from the end of the previous instance in that series i.e. from when the CCP from that previous instance has been reduced to 90% or below. However, it may be part of another series, depending on the timescales between it and other instances.

The P188 provisions will form an extension to the existing Level 2 Credit Default provisions.

### **1.4 Issues Raised by the Proposed Modification**

The following issues were considered during the Assessment of Proposed Modification P189:

- Existing provisions and incentives;
- Materiality / risk assessment;
- Timescales and thresholds;
- Persistent breaches;
- New level of Credit Default;
- Implementation options;
- Information on similar scenarios in other sectors;
- Interaction with existing provisions;
- Clarification of Working/Banking Day arrangements post-BETTA; and
- Involvement of the BSCCo and BSC Panel.

These issues are discussed in the Assessment Report (annex 3) and are not covered further here.

### **1.5 Assessment of how the Proposed Modification will Better Facilitate the Applicable BSC Objectives**

On the basis of its discussions, the Group concluded unanimously that:

- The current provisions relating to Credit Cover do not provide sufficient incentive for Trading Parties to post an appropriate amount of Credit Cover or maintain a CCP less than 100%;
- Trading Parties, particularly Suppliers, may accrue liabilities which they cannot pay;
- These unpaid liabilities form a significant risk to the industry;

- Provisions should be introduced to deal with Trading Parties who have a CCP greater than 100%;
- Unless Trading Parties reduce their CCP to 90% or below i.e. exit Level 2 Credit Default, within 2 Working Days after the breach of 100% CCP (plus any applicable Query Period from entering Level 1 Credit Default), they will be in Section H Default;
- Trading Parties breaching 100% CCP six times in a rolling period of six months should be in Section H Default, subject to there being a 'grace period' of 2 Working Days after a breach;
- These provisions should form an extension to the existing Level 2 Credit Default provisions; and
- No new compensation calculations need to be created for where a Trading Party is incorrectly assessed to have breached 100% CCP.

The unanimous view of the Group was that P188 would better facilitate the achievement of Applicable BSC Objectives (c) and (d) as it would reduce the potential exposure of BSC Parties to debts that they are not responsible for via the introduction of more robust credit arrangements, thus providing a more stable and secure marketplace. P188 would also ensure that Parties whose CCP is greater than 100% will be required to lodge a level of Credit Cover proportional to the activities it is undertaking, thus improving industry consistency in this area. The Group also believed that P188 may provide reduce the number of Parties entering Level 1 and 2 Credit Default, thus improving the efficiency of enacting the credit arrangements.

*(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;" and*

*(d) Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.*

The unanimous view of the Group was that P188 neither positively nor negatively facilitates the achievement of any of the other Applicable BSC Objectives.

The Group noted the arguments from the Assessment Consultation responses and the attendees at the second Modification Group meeting. These arguments largely stated that the P188 provisions were overly onerous for small Trading Parties and would also represent a barrier to entry for new entrants. As such, P188 would be detrimental to the achievement of Applicable BSC Objective (c). It was also stated that P188 would lead to more Trading Parties entering Section H Default. As such, P188 would be detrimental to the achievement of Applicable BSC Objective (d). The suggestion of a materiality threshold was raised in order to alleviate these concerns, such that all breaches of 100% CCP which corresponded to a materiality lower than this threshold would not be considered. However, the Group stated that this defeated the principle of the Modification, as any breach of 100% CCP posed a risk to the industry.

## **1.6 Governance and Regulatory Framework Assessment**

During the assessment of the Proposed Modification, the Group considered the wider implications of P188 in the context of the statutory, regulatory and contractual framework within which the Code sits, as is required by the Code (Annex F-1, Paragraph 1 (g)). No impact was noted.

## 2 COSTS<sup>2</sup>

### PROGRESSING MODIFICATION PROPOSAL

<b>Meeting Cost</b>	£ 1,000
<b>Legal/expert Cost</b>	£ 0
<b>Impact Assessment Cost</b>	£ 3,000
<b>ELEXON Resource</b>	45 Man days £ 9,180

### IMPLEMENTATION COSTS

		Stand Alone Cost	P188 Incremental Cost	Tolerance
<b>Service Provider<sup>3</sup> Cost</b>	Change Specific Cost	£ 69,547	£ 69,547	+/- 0%
	Release Cost	£ 124,222		+/- 0%
	Incremental Release Cost	£ 4,216	£ 4,216	+/- 0%
	<b>Total Service Provider Cost</b>	<b>£ 197,985</b>	<b>£ 73,763</b>	<b>+/- 0%</b>
<b>Implementation Cost</b>	External Audit	£ 0	£ 0	+/- 0%
	Design Clarifications	£ 9,899	£ 3,688	+/-100%
	Additional Resource Costs	£ 0	£ 0	+/- 0%
	Additional Testing and Audit Support Costs	£ 40,000		+/- 0%
<b>Total Demand Led Implementation Cost</b>	<b>£ 247,884</b>	<b>£ 77,451</b>	<b>+/- 0%</b>	

<sup>2</sup> Clarification of the meanings of the cost terms in this section can be found in annex 7 of this report

<sup>3</sup> BSC Agent and non-BSC Agent Service Provider and software Costs



<b>ELEXON Implementation Resource Cost</b>		214 Man days £ 47,080	54 Man days £ 11, 880	N/A
<b>Total Implementation Cost</b>		£ 294,964	£ 89,331	+/- 5%

## ONGOING SUPPORT AND MAINTENANCE COSTS

	Stand Alone Cost	P188 Incremental Cost	Tolerance
Service Provider Operation Cost	£ 0	£ 0	+/- 0%
Service Provider Maintenance Cost	£ 0	£ 0	+/- 0%
ELEXON Operational Cost	£ 2,200 per annum + £385 per Panel referral	£ 2,200 per annum + £385 per Panel referral	+/- 0%

### 3 RATIONALE FOR PANEL'S RECOMMENDATIONS

#### 3.1 Assessment Against the BSC Objectives

After the Assessment Procedure, the Panel Members were equally split on whether they supported the unanimous view of the Group that Proposed Modification P188 would better facilitate achievement of the Applicable BSC Objectives and should be made.

The supporting Panel Members believed that Proposed Modification P188 would reduce the risk to the industry from Parties breaching 100% CCP, and also increase industry consistency by providing an incentive for all Parties to lodge an appropriate amount of Credit Cover. It was also noted that P188 may reduce the number of occurrences of Credit Default, thus improving the efficiency of the overall process.

Those Panel Members not in support of the Proposed Modification believed that P188 would address the defect identified by the Modification Proposal, be detrimental to small Parties and provide a barrier to entry for new Parties. It was acknowledged that P188 highlighted a defect and risk in the existing provisions, however, these Panel Members stated that P188 would provide an inappropriate and extreme solution. Concerns were also raised in that the benefits provided by P188 had not been properly identified and quantified. One of these Panel Members acknowledged that the P188 provisions would be better than the existing provisions, but was concerned at the high implementation cost. This Panel Member also questioned the value of being referred to the Panel as a deterrent to Parties who breach 100%. However, it was noted that although the referral itself may not be a deterrent, the potential actions available to the Panel would be. In addition there was flexibility as the Panel had the ability to decide which actions to take. One Panel Member also questioned whether P188 would actually improve the efficiency of the process if it led to more Panel referrals.

Since the views of the Panel were evenly split, the Chairman was asked to use a deciding vote. The Chairman believed that P188 highlighted an important defect in the existing provisions, and that P188 would reduce an inappropriate risk to the industry. The Chairman stated that the industry should be protected by the Credit Default provisions, and noted that such protection was evident in other industries. As such, the Chairman supported the view that P188 should be made.

**At the Panel meeting on 11 August 2005 i.e. after the draft Modification Report consultation, one Panel Member changed his previous view on P188 and elected to support P188. As such, the Chairman was not required to vote and it was the majority view of the Panel that P188 would better facilitate the achievement of the Applicable BSC Objectives and should be made.**

### **3.2 Implementation Dates**

The Panel supported the proposed Implementation Dates recommended by the Group. Therefore, the Panel agreed that the recommended Implementation Date for Proposed Modification P188 should be:

- 27 June 2006, should the Authority determination be received on or before 21 December 2005; or
- Should an Authority determination be received after this date, but prior to 3 May 2006 then the Implementation Date should be 8 November 2006.

One Panel Member questioned whether the June release was soon enough, given that the Group wished to address a defect in the Code. However, it was acknowledged that the Group had discussed this point and wished to allow sufficient time both for system changes to be made and for small Parties to prepare for the changes e.g. accrue sufficient capital.

### **3.3 Legal Text**

The Panel noted the concerns about the draft legal text which had been raised by one of the respondents to the draft Modification Report consultation. The Panel agreed the changes to the legal text that had been made following the consultation and noted that no further changes were required.

### **3.4 Other Comments**

Some Panel Members noted that the Group was comprised of individuals employed by large rather than small Parties. However, it was also noted that small Parties had both responded to the assessment consultation and attended the second meeting of the Group. Some Panel Members were disappointed that no small Parties had taken part in either the teleconference or the draft Modification Report consultation.

One Panel Member asked whether the assessment consultation response suggesting a 3 Working Day timescale to lodge sufficient Credit Cover had been considered. This response highlighted the fact that 3 Working Days would be consistent with the timetable for non-payment of charges, and would also coincide with standard practice for default under the terms of the Grid Trade Master Agreement. It was stated that the Group had taken into account all consultation responses, but was concerned at the potential increase in risk to the industry should breaches of 100% CCP be allowed to endure. As such, the Group decided that the timescale should be increased from 1 to 2 Working Days to allow for financial practicalities, but not any further.

This Panel Member also questioned whether the consultation response suggesting a reduction threshold of 90% for the first breach of 100% CCP, and a reduction threshold of 75% for subsequent breaches, had been considered. It was stated that the Group had believed this suggestion to be very complicated

to monitor, and would result in either large system costs or in a large amount of complex analysis on a manual basis which would introduce an unacceptable level of risk and liability.

This Panel Member also questioned the Group's reasons for rejecting a materiality threshold on the breaches of 100% CCP i.e. a financial threshold below which the associated breaches would not be considered. This Panel Member stated that the main difficulty would be in selecting an appropriate threshold.

## **4 IMPACT ON BSC SYSTEMS AND PARTIES**

An assessment has been undertaken in respect of BSC Systems and Parties and the following have been identified as potentially being impacted by the Proposed Modification.

### **4.1 BSCCo**

The CVA Operations team will be required to monitor Energy Indebtedness data for breaches of 100% CCP and assess whether any Trading Party has persistently breached 100% as described in the Assessment Report. This team will also be required to enact the Section H Default processes, if required. This team will also need to update any pertinent Local Working Instructions.

The CVA Programme will be required to manage the implementation of the BSC Agent system changes and to draft and implement changes to the Code Subsidiary Documents. It will also be required to review changes to the BSC Agents' documentation. The Corporate Assurance team will be required to support these processes. The Business Process Model may also require amending in order to reflect the P188 provisions.

The Governance and Regulatory Affairs team may have a small increase in its operational workload due to unscheduled Panel meetings being required.

### **4.2 BSC Panel**

There may be a small increase in the Panel's workload due to unscheduled meetings taking place.

### **4.3 BSC Systems**

A BSC Agent Impact Assessment of Proposed Modification P188 was commissioned by the Group. The full response may be found in the Assessment Report (Annex 3). Note that the option chosen by the Group is Option 5b.

The ECVAA currently only notifies the BSCCo and the relevant Party of a breach of 100% CCP when the Credit Default Authorisation Flag (CDAF) is set to 'No' (i.e. the Party is not in Credit Default). No notification is sent when the Party reduces its CCP to be less than or equal to 100%.

In order to accommodate the P188 provisions, the ECVAA will notify the BSCCo and, following confirmation from the BSCCo, the relevant Party of a breach of 100% CCP only when the CDAF is set to 'Yes' (i.e. the Party is in Credit Default). This will reflect the fact that a Party going straight to above 100% from below 80% CCP is not in Credit Default until its Query Period is over. Also, once the Party is considered to be in Credit Default with a CCP greater than 100%, the ECVAA will notify the BSCCo and, following confirmation from the BSCCo, the relevant Party when the CCP is reduced to 90% or below and/or the CDAF is set to 'No'.

### **4.4 Parties and Party Agents**

The full responses may be found in the Assessment Report (Annex 3). One Party stated that it would require one month to implement the necessary processes and procedures to accommodate P188, but

did not give a cost for this. Another Party stated that it would require 12 months to raise sufficient funds and to install an appropriate infrastructure in order to monitor its CCP. This Party also stated that the cost of making these changes may approach its annual profit.

The Group noted and acknowledged the one-month impact, but felt that the reasons given for an impact lasting 12 months were inadequate. It was felt that a solvent Party should not require that long to raise funds, and also that all Parties should be monitoring their CCP, given the risk associated with entering Credit Default. As such, the proposed Implementation Date does not allow a 12-month lead time.

## 5 IMPACT ON CODE AND DOCUMENTATION

### 5.1 Balancing and Settlement Code

The legal text giving effect to P188 may be found in annex 1 of this document.

A summary of the changes are provided below:

Section H – General:

- The circumstances under which a Trading Party is liable to enter Section H Default will require amendment.

Section M – Credit Cover and Credit Default:

- The process to be followed once the CCP has breached 100% will need to be described; and
- The provisions relating to persistent breaches of 100% CCP will also need to be described.

### 5.2 Code Subsidiary Documents

The ECVAA Service Description will require amendment to reflect when the ECVAA notifies the BSCCo and Parties of breaches of 100% CCP.

## 6 SUMMARY OF CONSULTATIONS

A consultation on the draft Modification Report was issued on 20 July 2005 with responses due on 29 July 2005. 5 responses representing 31 Parties were received.

Consultation question	Respondent agrees	Respondent disagrees	Opinion unexpressed
Do you agree with the Panel's views on P188 and the provisional recommendation to the Authority contained in the draft Modification Report that P188 should be made?	6 (46)	0	0
Do you agree with the Panel's view that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal?	5 (41)	0	1 (5)
Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P188?	6 (46)	0	0

The respondents agreed unanimously with the Panel's views on P188 and the provisional recommendation that P188 should be made. The respondents also agreed unanimously on the Panel's provisional recommendation for the Implementation Date for P188. Of those who expressed an

opinion, the respondents agreed unanimously with the Panel's view that the legal text correctly addressed the defect highlighted by P188. However, one respondent highlighted some concerns over the legal text as described below.

One respondent questioned how the 2 Working Days within which a Party would be required to reduce its CCP to 90% or below would be counted. The respondent held the view that the wording of "within 2 Working Days" implied that a Party would have until midnight at the end of the second Working Day to reduce its CCP to 90% or below. However, the BSCCo's view was that, as defined in Section X of the Code, a Working Day is deemed to end at 5pm. It was thus brought to light that the legal text would not reflect how the Group wanted this timescale to work. The Group had requested that a Party should have 16 'working hours' (i.e. those within the timescale of 9am-5pm) to reduce its CCP to 90% or below. For example, a breach occurring at 10am on Thursday should have until 10am on Monday to be resolved. The current drafting would only allow until 5pm on Friday. As such, the legal drafting was amended to reflect the Group's intentions. This same amendment applied to the legal text pertaining to persistent breaches.

The respondent's other concerns related to whether the drafting should relate to "instants" of Level 2 Credit Default combined with breaches of 100% CCP, rather than "instances". However, it was agreed that since the persistent breaches provisions pertained to the clock starting from the reduction of CCP to 90% or below, rather than the initial breach, it would be more appropriate to use "instances" with defined start and end points. The respondent was then concerned that an 'instance' was not currently defined clearly enough. However, it was the BSCCo's view that it was adequately defined. As such, no changes to the legal text were made in relation to these concerns.

The points above were discussed with the respondent who agreed with the material changes made. In relation to the clarification on the definition of an 'instance', the respondent disagreed with the BSCCo's view but did not wish to pursue this comment further.

## **6.1 Comments and Views of the Panel**

The Panel noted the contents of the Report Phase consultation responses at its meeting held on 11 August 2005. The Panel noted the comments of one respondent regarding the legal text, and noted BSCCo's legal view that no change to the text was required other than the clarification regarding the relevant timescales.

## **7 SUMMARY OF TRANSMISSION COMPANY ANALYSIS**

### **7.1 Analysis**

The full response may be found in annex 3 of this document. In the event of P188 being approved, the Transmission Company does not anticipate any impact on its ability to discharge its obligations efficiently under the Transmission Licence, or on its ability to operate an efficient, economical and co-ordinated transmission system. Further, the Transmission Company does not anticipate any impact on its computer systems and processes or any costs as a result of implementing P188 and any consequential change to Core Industry Documents.

It is the view of the Transmission Company that P188 would better facilitate the achievement of Applicable BSC Objectives (c) and (d), on the basis that it would introduce more robust credit arrangements to provide a more stable and secure marketplace. Further, the Transmission Company believes that P188 would reduce the potential exposure of Parties to debts that they are not responsible for.

## 7.2 Comments and Views of the Panel

The Panel noted the lack of impact on the Transmission Company in the event of P188 being approved, and also the Transmission Company's support for the Proposed Modification.

## 8 IMPLEMENTATION APPROACH

The recommended Implementation Dates for Proposed Modification P188 allow a 27 week lead time following an Authority decision in order make the required system changes and to progress the required documentation and process changes through the industry review and approval process. Furthermore, the recommended Implementation Dates are consistent with the CVA Release strategy as follows:

- 27 June 2006, should an Authority decision be received on or before 21 December 2005; or
- 8 November 2006, should an Authority decision be received after 21 December 2005, but on or before 3 May 2006.

If approved, P188 would only apply to CCPs calculated on or after the Implementation Date.

## 9 DOCUMENT CONTROL

### 9.1 Authorities

Version	Date	Author	Reviewer	Change Reference
0.1	19/07/05	Change Delivery	Tom Bowcutt	Peer Review
0.2	20/07/05	Change Delivery	Sarah Jones	Technical Review
0.3	20/07/05	Change Delivery	Industry	For Consultation
0.4	01/08/05	Change Delivery	Sarah Jones	Technical Review
0.5	04/08/05	Change Delivery	Martin Thompson	Quality Review
0.6	05/08/05	Change Delivery	Panel	For Panel Decision
0.7	11/08/05	Change Delivery	Sarah Jones	Technical Review
1.0	15/08/05	Change Delivery	Authority	For Authority Decision

### 9.2 References

Ref	Document	Owner	Issue date	Version
1	Modification Proposal P188 'Revision of Credit Default Provisions' <a href="http://www.elexon.co.uk/documents/modifications/188/P188.pdf">http://www.elexon.co.uk/documents/modifications/188/P188.pdf</a>	BSCCo	03/05/05	1.0
2	Issue 16 'Credit Default and the Default provisions in Section H of the BSC' <a href="http://www.elexon.co.uk/documents/modifications/188/P188_Attachment_1.pdf">http://www.elexon.co.uk/documents/modifications/188/P188_Attachment_1.pdf</a>	BSCCo	20/04/05	N/A
3	P188 Initial Written Assessment <a href="http://www.elexon.co.uk/documents/BSC_Panel_and_Panel_Committees/BSC_Panel_Meetings_2005_-_092_-_papers/92_007.pdf">http://www.elexon.co.uk/documents/BSC_Panel_and_Panel_Committees/BSC_Panel_Meetings_2005_-_092_-_papers/92_007.pdf</a>	BSCCo	06/05/05	1.0
4	P188 Assessment Consultation <a href="http://www.elexon.co.uk/documents/Consultations/P188_Assessment_Consultation/P188AC10.pdf">http://www.elexon.co.uk/documents/Consultations/P188_Assessment_Consultation/P188AC10.pdf</a>	BSCCo	08/06/05	1.0

**ANNEX 1 LEGAL TEXT**

Attachment 1 contains the legal text for Proposed Modification P188.

**ANNEX 2 MODIFICATION GROUP DETAILS**

NAME	POSITION	MEMBER	MEETING ATTENDANCE		
			17/05/2005	23/06/2005	07/07/2005 (Teleconference)
Tom Bowcutt	ELEXON (Chairman)	Y	✓	✓	☎
David White	ELEXON (Lead Analyst)	Y	✓	✓	☎
Mark Manley	BGT - Proposer's Rep.	Y	✓	✓	☎
Andrew Colley	Scottish and Southern	Y	✓	✓	X
Steve Drummond	EDF Trading	Y	X	✓	X
Paul Jones	E.ON UK	Y	X	✓	X
Man Kwong Liu	SAIC	Y	X	✓	X
Stephen Moore	EDF Energy	Y	✓	✓	☎
Neil Smith	E.ON UK	Y	✓	X	☎
Carl Wilkes	Npower	Y	✓	✓	☎
Darren Bourke	ELEXON (CVA Operations)	N	✓	✓	☎
Alan Goodbrook	Utility Link	N	X	✓	X
Richard Hall	Authority	N	✓	✓	☎
Chris Mays	ZEST 4	N	X	✓	X
Keith Munday	Bizz Energy	N	X	✓	X
Sandra Wybrow	ELEXON (Legal)	N	✓	X	☎

**Terms of Reference:**

- Existing Provisions and Incentives;
- Materiality / Risk Assessment;
- Timescales and Thresholds;
- Persistent Breaches;
- New level of Credit Default;
- Implementation Options;
- Information on Similar Scenarios in other Sectors
- Interaction with existing provisions;
- Clarification of Working/Banking Day Arrangements Post-BETTA; and
- Involvement of the BSCCo and BSC Panel.

**ANNEX 3 ASSESSMENT REPORT**

Attachment 2 contains the Assessment Report for P188 while Attachment 3 contains the responses to the Assessment Consultation associated with this Assessment Report.

**ANNEX 4 CLARIFICATION OF COSTS**

There are several different types of costs relating to the implementation of Modification Proposals. ELEXON implements the majority of Approved Modifications under its CVA or SVA Release Programmes. These Programmes incur a base overhead which is broadly stable whatever the content of the Release. On top of this each Approved Modification incurs an incremental implementation cost. The table of estimated costs of implementing the Proposed/Alternative Modification given in section 2 of this report has three columns:

- **Stand Alone Cost** – the cost of delivering the Modification as a stand alone project outside of a CVA or SVA Release, or the cost of a CVA or SVA Release with no other changes included in the Release scope. This is the estimated maximum cost that could be attributed to any one Modification implementation.
- **Incremental Cost** - the cost of adding that Modification Proposal to the scope of an existing release. This cost would also represent the potential saving if the Modification Proposal was to be removed from the scope of a release before development had started.
- **Tolerance** – the predicted limits of how certain the cost estimates included in the template are. The tolerance will be dependent on the complexity and certainty of the solution and the time allowed for the provision of an impact assessment by the Service Provider(s).

The cost breakdowns are shown below:



<b>PROGRESSING MODIFICATION PROPOSAL</b>	
<b>Meeting Cost</b>	This is the cost associated with holding Modification Group meetings and is based on an estimate of the travel expenses claimed by Modification Group members.
<b>Legal/expert Cost</b>	This is the cost associated with obtaining external expert advice, usually legal advice.
<b>Impact Assessment Cost</b>	Service Provider Impact Assessments are covered by a pre-determined monthly contractual charge. Therefore the cost included in this report is an estimate based on the level of impact assessment that the modification is expected to require and may not reflect the actual cost attributed to the modification, which will be based on a percentage of the contractual impact assessment costs for each month that it is assessed.
<b>ELEXON Resource</b>	This is the ELEXON Resource requirement to progress the Modification Proposal through the Modification Procedures. This is estimated using a standard formula based on the length of the Modification Procedure.

<b>SERVICE PROVIDER<sup>4</sup> COSTS</b>	
<b>Change Specific Cost</b>	Cost of the Service Provider(s) Systems development and other activities relating specifically to the Modification Proposal.
<b>Release Cost</b>	Fixed cost associated with the development of the Service Provider(s) Systems as part of a release. This cost encompasses all the activities that would be undertaken regardless of the number or complexity of changes in the scope of a release. These activities include Project Management, the production of testing and deployment specifications and reports and various other standard release activities.
<b>Incremental Release Cost</b>	Additional costs on top of base Release Costs for delivering the specific Modification Proposal. For instance, the production of a Test Strategy and Test Report requires a certain amount of effort regardless of the number of changes to be tested, but the addition of a specific Modification Proposal may increase the scope of the Test Strategy and Test Report and hence incur additional costs.

<b>IMPLEMENTATION COSTS</b>	
<b>External Audit</b>	Allowance for the cost of external audit of the delivery of the Modification Proposal. For Modification Proposals, which impact CVA BSC Agent software, this is typically estimated as 8% of the total Service Provider Costs, with a tolerance of +/- 20%. ELEXON does, however, have internal audit capabilities and if the software change is low risk and low complexity it may be decided that it is more appropriate to utilise this internal resource. This would result in zero demand led audit costs offset by an

<sup>4</sup> A Service Provider can be a BSC Agent or a non-BSC Agent, which provides a service or software as part of the BSC and BSC Agent Systems. The Service Provider cost will be the sum of the costs for all Service Providers who are impacted by the release.

	<p>increase in ELEXON Operational costs for that specific change.</p> <p>At present the SVA Programme does not use an external auditor, so there is no External Audit cost associated with an SVA BSC Systems Release.</p>
<b>Design Clarifications</b>	<p>Allowance to cover the potential cost of making any amendments to the proposed solution to clarify any ambiguities identified during implementation. This is typically estimated as 2.5% of the total Service Provider Costs, with a tolerance of +/- 100%.</p>
<b>Additional Resource Costs</b>	<p>Any short-term resource requirements in addition to the ELEXON resource available. For CVA BSC Systems Releases, this is typically only necessary if the proposed solution for a Modification Proposal would require more extensive testing than normal, procurements or 'in-house' development.</p> <p>For SVA BSC Systems Releases, this will include the management and operation of the Acceptance Testing and the associated testing environment.</p> <p>This cost relates solely to the short-term employment of contract staff to assist in the implementation of the release.</p>
<b>Additional Testing and Audit Support Costs</b>	<p>Allowance for external assistance from the Service Provider(s) with testing, test environment and audit activities. Includes such activities as the creation of test environments and the operation of the Participant Test Service (PTS). For CVA BSC Systems Releases involving NETA Central Service Agent software changes, this is typically estimated as £40k per release with at tolerance of +/-25%. For SVA BSC Systems Releases this is estimated on a Modification Proposal basis.</p>

**TOTAL DEMAND LED IMPLEMENTATION COSTS**

This is calculated as the sum of the total Service Provider(s) Cost and the total Implementation Cost. The tolerance associated with the Total Demand Led Implementation Cost is calculated as the weighted average of the individual Service Provider(s) Costs and Implementation Costs tolerances. This tolerance will be rounded to the nearest 5%.

**ELEXON IMPLEMENTATION RESOURCE COSTS**

Cost quoted in man days multiplied by project average daily rate, which represents the resources utilised by ELEXON in supporting the implementation of the release. This cost is typically funded from the "ELEXON Operational" budget using existing staff, but there may be instances where the total resources required to deliver a release exceeds the level of available ELEXON resources, in which case additional Demand Led Resources will be required.

The ELEXON Implementation Resource Cost will typically have a tolerance of +/- 5% associated with it.

<b>ONGOING SUPPORT AND MAINTENANCE COSTS</b>	
<b>ELEXON Operational Cost</b>	Cost, in man days per annum multiplied by project average daily rate, of operating the revised systems and processes post implementation.
<b>Service Provider Operation Cost</b>	Cost in £ per annum payable to the Service Provider(s) to cover staffing requirements, software or hardware licensing fees, communications charges or any hardware storage fees associated with the ongoing operation of the revised systems and processes.
<b>Service Provider Maintenance Cost</b>	Cost quoted in £ per annum payable to the Service Provider(s) to cover the maintenance of the amended BSC Systems. Note that from 1 January 2005, Service Provider Maintenance costs will be covered by a fixed contractual charge and so any Modification Proposals implemented after this date will not incur an ongoing Service Provider Maintenance cost.

## **ANNEX 5 CONSULTATION REPONSES**

Attachment 4 contains the responses to the draft Modification Report consultation.