

**ASSESSMENT REPORT for Modification Proposal P170
Amendments to the Balancing and Settlement Code
(Code), and to the systems and processes that support
it, to allow compliance with the changed application of
VAT to Trading Charges**

Prepared by: P170 Modification Group

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This document has been distributed in accordance with Section F2.1.10¹ of the Balancing and Settlement Code.

RECOMMENDATIONS

The P170 Modification Group invites the Panel to;

- **AGREE that the Proposed Modification P170 should be made;**
- **AGREE a provisional Implementation Date for Proposed Modification P170 of 5 Working Days after an Authority decision;**
- **AGREE that Modification Proposal P170 be submitted to the Report Phase; and**
- **AGREE that the draft Modification Report be issued for consultation and submitted to the Panel Meeting of 11 November 2004.**

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¹ The current version of the Balancing and Settlement Code (the 'Code') can be found at www.elexon.co.uk/ta/bscres_docs/bsc_code.html

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SUMMARY OF IMPACTED PARTIES AND DOCUMENTS

As far as the P170 Modification Group has been able to assess the following parties/documents have been identified as being potentially impacted by Modification Proposal P170.

Parties	Sections of the BSC ²	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 type="checkbox"/>
Transmission Company <input type="checkbox"/>	D <input checked="" 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"/>
Party Agents		
Data Aggregators <input type="checkbox"/>	G <input type="checkbox"/>	Reporting Catalogue <input type="checkbox"/>
Data Collectors <input type="checkbox"/>	H <input type="checkbox"/>	MIDS <input type="checkbox"/>
Meter Operator Agents <input type="checkbox"/>	I <input type="checkbox"/>	Core Industry Documents
ECVNA <input type="checkbox"/>	J <input type="checkbox"/>	Grid Code <input type="checkbox"/>
MVRNA <input type="checkbox"/>	K <input type="checkbox"/>	Supplemental Agreements <input type="checkbox"/>
BSC Agents		
SAA <input type="checkbox"/>	L <input type="checkbox"/>	Ancillary Services Agreements <input type="checkbox"/>
FAA <input type="checkbox"/>	M <input checked="" type="checkbox"/>	Master Registration Agreement <input type="checkbox"/>
BMRA <input type="checkbox"/>	N <input type="checkbox"/>	Data Transfer Services Agreement <input type="checkbox"/>
ECVAA <input type="checkbox"/>	O <input type="checkbox"/>	British Grid Systems Agreement <input type="checkbox"/>
CDCA <input type="checkbox"/>	P <input type="checkbox"/>	Use of Interconnector Agreement <input type="checkbox"/>
TAA <input type="checkbox"/>	Q <input type="checkbox"/>	Settlement Agreement for Scotland <input type="checkbox"/>
CRA <input type="checkbox"/>	R <input type="checkbox"/>	Distribution Codes <input type="checkbox"/>
Teleswitch Agent <input type="checkbox"/>	S <input type="checkbox"/>	Distribution Use of System Agreements <input type="checkbox"/>
SVAA <input type="checkbox"/>	T <input type="checkbox"/>	Distribution Connection Agreements <input type="checkbox"/>
BSC Auditor <input type="checkbox"/>	U <input type="checkbox"/>	BSCCo
Profile Administrator <input type="checkbox"/>	V <input type="checkbox"/>	Internal Working Procedures <input type="checkbox"/>
Certification Agent <input type="checkbox"/>	W <input type="checkbox"/>	Other Documents
MIDP <input type="checkbox"/>	X <input type="checkbox"/>	Transmission Licence <input type="checkbox"/>
Other Agents		
SMRA <input type="checkbox"/>		
Data Transmission Provider <input type="checkbox"/>		

X = Identified in Report for last Procedure
N = Newly identified in this Report

² The Initial Written Assessment of P170 suggested that changes might be required to Sections A, D, H, N, Annex S-1, X and Annex X-1 of the Code might be required. The Group has considered the impact on these sections in its deliberations, and believes required changes are restricted to Sections D and N.

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

1.1 Modification Proposal

1.1.1 Aim of Modification Proposal

Modification Proposal P170 'Amendments to the Balancing and Settlement Code (Code), and to the systems and processes that support it, to allow compliance with the changed application of VAT to Trading Charges' ('P170') was raised by the BSC Panel ('the Proposer') on 12 August 2004.

P170 proposes that the Code be modified to cater for a change in Value Added Tax (VAT) law. The Council of the European Union has directed an amendment to the rules on the place of supply of gas and electricity, for the purposes of turnover taxes³ (hereafter referred to as 'the Directive'). This amendment takes effect from 1 January 2005 and impacts the application of VAT to the supply of electricity.

P170 was raised by the Panel on the recommendation of ELEXON in accordance with section F2.1.1(d)(i) of the Code.

The proposal suggests that the Code currently lacks appropriate obligations for Parties to provide relevant VAT information and provide indemnification against costs or penalties that might result from erroneous declarations. It is contended that the absence of such obligations may prevent ELEXON and Parties from complying with the legislation and therefore detrimentally impact upon the efficiency of the implementation and administration of the balancing and settlement arrangements.

The Panel's initial view was that P170 would better facilitate Applicable BSC Objective (d):

'promoting efficiency in the implementation and administration of the balancing and settlement arrangements'.

The basis for this initial view was that efficiency would be better achieved by ensuring that Parties provide relevant information to allow the correct application of VAT to the charges for which they are liable under the Code, and by providing that appropriate indemnification is provided to BSCCo so that consequential costs arising from an erroneous VAT declaration by a Party rest with that Party rather than with the wider BSC community through funding shares.

The Panel recommended that a new Modification Group should be formed (hereafter referred to as 'the Group'), and that this should contain members with VAT as well as Code expertise.

1.1.2 Process followed for P170

The following deliverables resulted from the Assessment Procedure for P170:

- The Group met twice, on 6 September and 29 September 2004, to consider P170 against its Terms of Reference set down by the Panel;
- One industry consultation was issued;
- One impact assessment from the Transmission Company was requested;
- Draft legal text was commissioned; and
- The content of this Assessment Report was agreed.

³ The amendment is contained within Council Directive 2003/92/EC, which amends Directive 77/388/EEC as regards the rules on the place of supply of gas and electricity. A hyperlink to this document is contained within Reference 1 of this document.

1.1.3 Amendments to underlying systems and processes

Subsequent to P170 being raised, ELEXON separately raised Change Proposal 1078 'System and process changes required to allow compliance with the changed application of VAT to Trading Charges' ('CP1078') on 19 August 2004. The decision to raise a Change Proposal was taken because impact assessments suggested that ELEXON and the Funds Administration Agent (FAA) must start the development of the system and process changes required during September 2004 in order to comply with the change in VAT law by its effective date. It is anticipated that the Modification Report for P170 will not be issued to the Authority until after the Panel meeting scheduled for 11 November 2004.

The Imbalance Settlement Group (ISG), acting under delegated authority from the Panel, approved CP1078 on 8 September 2004.

It should be stressed that CP1078 is not an alternative or substitute to P170. P170 proposes putting in place obligations on Parties (further detailed in sections 1.3 and 5 of this document) that cannot be achieved through a Change Proposal. The simplest way to explain the distinction between P170 and CP1078 is that the former seeks to deliver Code obligations to enforce compliance with the changed application of VAT and protect other Parties from incurring costs relating to erroneous VAT declarations, whilst the latter will put in place delivery mechanisms to allow the correct application of VAT in payment processes (but without any obligations to enforce the provision of relevant information or mitigate against any cost consequences of erroneous VAT declarations if implemented in isolation).

The separation of system and process changes into CP1078 means that these are not required under P170.

1.2 Proposed Modification

The Group has developed P170 as a Code only change, noting that systems and process changes will be catered for under CP1078.

The issues considered by the Group in developing the legal text are reflected in section 1.3 of this document. The draft legal text is appended to this document.

1.3 Issues raised by the Proposed Modification

1.3.1 Obligations for a Party to declare its VAT status

The Group noted that Parties currently declare VAT details using two separate mechanisms: one Code mandated; and one contained within a BSC Procedure (BSCP).

Prior to acceding to the Code, a Party Applicant shall submit to the BSCCo a duly completed application form, in such form as BSCCo may from time to time prescribe, giving its Party Details at the time of its application⁴. These Party Details include whether the Party is registered for VAT purposes and if so the Party's VAT registration number⁵. This application form is normally referred to as the accession form, and is published on the BSC Website.

Once acceded to the Code, a Payment Party (ie a Party who is obliged to make or entitled to receive payment for Trading Charges) may provide amended VAT details to the FAA using forms contained within BSCP301, 'Clearing, Invoicing and Payment'. It should be noted that not all Parties are Payment Parties⁶.

⁴ Pursuant to A2.2.1 of the Code.

⁵ Pursuant to A3.1.1(i) of the Code.

⁶ An example of a Party that would not be a Payment Party would be a non-physical trader that balances its contractual position. In practice, any Party that does not make or receive payments from ELEXON Clear is not a Payment Party.

The Group notes that the Code obligation to provide VAT information is restricted to providing a VAT number upon acceding to the Framework Agreement and that no obligation exists for a Party to declare whether they are liable to UK VAT or not either upon accession or subsequently. A Group member stated that a Party's liability for UK VAT will be driven by its place of establishment under the Directive. This would mean that a Party whose place of supply for the purposes of the Directive is outside the UK should not be subject to UK VAT, regardless of whether they had informed the BSCCo or FAA of this. This interpretation was agreed with by other members of the Group. In practice however, UK VAT would continue to be applied until the Party has provided details of its European Union (EU) VAT registration details or confirmation that they are established outside the EU.

Therefore the Group believe that Parties should be obligated to provide relevant information to BSCCo to allow the correct application of VAT to charges incurred under the Code rather than BSCCo making assumptions based on the Party's registered address. Consideration was given to how this should be achieved.

One option would be to explicitly stipulate all the information required in the Code. The Group is concerned that this route would result in the Code being inflexible to future changes to VAT information required, with subsequent Modification Proposals being required to cater for such changes if the Code was too specific on information required and subsequent practical requirements deviated from these Code obligations.

A second option considered was to make Code obligations on VAT information provision more generic. Under this option, the Code would stipulate that Parties would provide BSCCo with all relevant information to allow the correct application of VAT. It was argued that such an approach would result in a 'future-proof' solution that could adapt to any subsequent changes in VAT law. The Group was broadly supportive that this approach would be 'future-proof', but several members expressed concerns that an overly generic obligation on Parties to provide such information as BSCCo may request or require for VAT purposes may not be the best solution. This is based on a concern that this approach might give BSCCo open-ended powers to request information from Parties that might not be strictly required to allow VAT compliance. A concern was raised that any changes to BSCCo requirements for relevant VAT information should be conducted under the auspices of a mechanism subject to appropriate public scrutiny.

The final approach considered by the Group was to put in place an obligation in the Code for Parties to provide such information as is stipulated in a relevant Code Subsidiary Document. This approach is perceived as being the most preferable of the three considered. The Group believes this approach will minimise the risk of future Code changes being required to cater for amendments to the VAT information required from Parties, by avoiding detailing all the required information within the Code. In addition, by putting the information required from a Party into a Code Subsidiary Document, any changes to it will be subject to BSCP40, 'Change Management', and therefore subject to appropriate scrutiny by Parties and other stakeholders.

The Group has agreed that the draft legal text should stipulate that Parties shall provide relevant VAT information to BSCCo in line with BSCP301.

The Group agreed that the default assumption in any legal text should be that a Party is liable to UK VAT unless it declares otherwise. The draft legal text appended to this document contains provisions in line with this assumption.

1.3.2 Party responsibility for erroneous VAT declarations

The Group considered whether the Code contains appropriate obligations on Parties to take responsibility for the cost consequences of any erroneous VAT declarations. It was agreed that there are no clear provisions in this area.

The Group noted that the BSCCo's funding structure is such that a significant proportion of costs incurred are smeared across Parties through use of the Funding Shares set out in Section D of the Code. This means that any costs or penalties currently picked up by BSCCo in relation to VAT prompted by erroneous declarations of one Party may be paid for by other Parties.

The Group believe this to be unfair, and that any financial consequences resulting from erroneous VAT declarations made by a Party should be borne by that Party.

1.3.3 Definition of VAT within the Code

The Group considered whether the definition of VAT within the Code would require amendment. 'VAT' is currently defined simply as meaning 'United Kingdom Value Added Tax'.

A member indicated that they felt the issue was to ensure that the definition worked in appropriate contexts within the Code. This need not necessitate a change to the definition of VAT provided that in each case where 'VAT' is referred to it is clear what should be applied. VAT is currently referred to in sections A, D, H, N, Annex S-1, X and Annex X-1 of the Code.

As the BSCCo and BSC Clearer will only apply UK VAT in their processes, it is considered that the current definition of VAT in the Code is correct, and that the P170 legal text only needs to clearly indicate if UK VAT should be applied or not to allow this definition to work.

This view received consensus support within the Group, and the draft legal text they have developed does not propose alterations to the definition of VAT within the Code or to Sections A, H, Annex S-1, X or X-1 of the Code.

1.3.4 Accounting for deficit or surplus of VAT between ELEXON Clear and ELEXON Limited

The Group noted that the impact of the VAT law change has a significant impact upon the role of the BSCCo and the BSC Clearer. BSC Trading Charges are currently set up such that the Total System Residual Cashflow counterbalances the five other Trading Charges⁷. Because UK prevalent rate VAT is currently applied to each charge for all Payment Parties, the application of VAT does not impact upon the balancing effect of the Total System Residual Cashflow.

Following 1 January 2005, based upon the assumption that some Parties will not be liable to UK VAT upon their Trading Charges from that date, this will no longer be the case. Whilst the net (VAT exclusive) BSC Clearer cashflows will balance to zero, the gross (VAT inclusive) BSC Clearer cashflows will not. The effect of this is that the BSC Clearer will see a surplus or deficit of funds for each Payment Date driven by VAT imbalances.

Agreement has been reached between Deloitte and Touche, ELEXON's auditors, and Customs and Excise that such VAT imbalances should be settled by ELEXON Limited using its current VAT registration. This will therefore require ELEXON Clear (as the BSC Clearer) to debit or credit ELEXON Limited (BSCCo) with daily VAT imbalances.

The Group noted that the ability of the BSC Clearer to make payments on a Business Day is limited within the Code. N2.7.1 sets out that BSC Clearer payments are limited to the amount that has been paid to or recovered by the BSC Clearer from Parties in respect of that Business Day. The Code is silent on any mechanisms to credit or debit cash surpluses or deficits between the BSC Clearer and BSCCo.

The Group considered that the Code requires amendments to ensure that the BSC Clearer is not restricted from making full payments in respect of a Business Day where funds owing exceed funds

⁷ Total System Information Imbalance Charge, System Operator BM Cashflow, Total System Non-Delivery Charge, Total System BM Cashflow and Total System Energy Imbalance Cashflow. For further information on the definitions of these cashflows, please see section T of the Code.

received resulting from a VAT imbalance. It was agreed that the liability of the BSC Clearer to make payments to Parties on a Business Day should be limited so that net (VAT exclusive) amounts payable do not exceed net (VAT exclusive) amounts received in order to ensure that the BSC Clearer continues to be protected from the risk of insolvency. It was further agreed that the legal text should provide for the BSCCo to receive or provide funds to the BSC Clearer to resolve its VAT imbalances.

1.3.5 Interrelation with CP1078

The Group noted that the intention of CP1078 is to utilise existing BSCP301, 'Clearing, Invoicing and Payment' and the accession form as the mechanisms by which Parties could declare relevant VAT details. The Group agreed that any amended Code provisions obligating Parties to provide VAT information should be mindful that these documents will facilitate discharging this obligation.

A member noted that separately from the Directive impacting the place of supply for electricity for the purposes of turnover taxes, an Invoicing Directive⁸ took effect from 1 January 2004 stipulating information that should be contained on VAT invoices. ELEXON confirmed to the Group that it was aware of the requirements of the Invoicing Directive in this regard, and that the proposed CP1078 solution contains provisions to comply with it.

1.3.6 Section D Charges

The Group noted the advice given to ELEXON Limited by Deloitte and Touche with regard to Section D Charges. ELEXON has been advised that:

Charges made under Section D of the Balancing and Settlement Code should adopt the same liability to VAT as Trading Charges. This is on the basis that the services provided by ELEXON can be described as:

'consisting of any other activity intended to facilitate the making of a supply of electricity to a person outside the UK'.

If this is the case, supply made by ELEXON will be made, for VAT purposes, in the country where the Trading Party is established. If the Trading Party is outside the UK, no UK VAT will be due.

The Group understand that whilst agreement has been reached with Customs and Excise on the approach to be taken with regard to Trading Charges, that no explicit agreement has been reached with regard to Section D Charges.

The Group requested that ELEXON take steps to confirm both if and when agreement is likely to be reached in this regard. ELEXON has confirmed that Deloitte and Touche is finalising a formal agreement with Customs and Excise that will stipulate the treatment of Section D Charges. It should be noted that neither the Group, ELEXON or Deloitte and Touche is in a position to guarantee that agreement will be reached with Customs and Excise on this issue.

The Group has developed legal text that requires the payment of applicable VAT on transactions that they consider will work whether or not Customs and Excise agree to this treatment of Section D charges.

⁸ The EC VAT Invoicing Directive (2001/115/EC) amends Article 22 of the EC Sixth VAT Directive. The Directive has been implemented into UK law by section 24 of the Finance Act 2002.

1.3.7 Issues outside the Terms of Reference

1.3.7.1 Implementation Date

The Group considered what Implementation Date should be provided with any recommendation to the Authority. Several members expressed discomfort with the idea of stipulating a precise calendar date for implementation. There was concern that such an approach might set up a logical conflict were an Authority determination to be reached after the stipulated Implementation Date. Such a circumstance might be possible given that an Authority determination would not be sought until mid-November 2004 whilst the effective from date of the VAT law change is 1 January 2005.

The Group considered that any decision should be framed as taking effect a specified number of days after an Authority determination.

The Group considered whether there should be a further period of time after the Implementation Date before the provisions take effect (ie a 'grace period' before Code obligations become binding). Such an approach would involve an Implementation Date of a specified number of Working Days after an Authority decision, plus a Relevant Implementation Date of a specified number of Working Days after the Implementation Date. Taking into account consultation responses which encourage a minimal implementation timescale, the Group agreed that there was no need for a Relevant Implementation Date. The Group considered that affected Parties should be aware of the changes to VAT law and therefore that the time between an Authority decision and the actual Implementation Date would be sufficient.

It was noted that the FAA issues advice notes three Working Days in advance of the due Payment Date and that they had indicated in impact assessments for CP1078 that they would require five Working Days notice of any change to a Party's VAT details. The Group is therefore minded that the latest date on which a Party should provide relevant VAT information if its place of supply for the purposes of the Directive is outside the UK will be 23 December 2004 to allow correct invoicing from 1 January 2005. The changes prescribed by CP1078 are due to take effect on 17 December 2004 and the Group expressed the view that the correct order for P170 and CP1078 to be implemented would be such that Code obligations are in place prior to this date in order to ensure that Parties are obliged to use the CP1078 information delivery systems from its go-live date. The Group therefore believes that, if possible, P170 should be implemented in advance of CP1078.

At this stage it is anticipated that P170 will only require Code changes and will not require underlying systems and process changes as these will be captured under CP1078. Where Code only changes are required to implement a Modification Proposal, an Implementation Date of five Working Days after the Authority decision date may be possible. The Group therefore recommend an Implementation Date of five Working Days after an Authority determination.

1.3.7.2 Credit Assessment Price

The Group also considered the impact of VAT on the Credit Assessment Price (CAP), in view of a consultation response querying this issue.

CAP is used by the FAA to convert the Credit Cover lodged by a Party against outstanding Trading Charges from a cash figure to a MWh figure. This conversion is necessary because one component of the Energy Indebtedness calculation, Credit Assessment Energy Indebtedness (CEI), is based upon a notional estimation of expected energy imbalance volumes in MWh rather than a cash figure. CAP may be re-determined by the Panel from time to time in accordance with the provisions of Section M of the Code, and is currently set to £18 plus VAT per MWh (£21.15 including VAT). The Code makes no mention of VAT in relation to CAP and does not suggest whether CAP should be VAT inclusive or VAT exclusive. The parameter is currently treated as set to £21.15 per MWh.

The Group noted advice from ELEXON that the current calculation of Actual Energy Indebtedness (AEI) is based upon a net estimation (ie VAT exclusive) rather than a gross estimation (ie VAT inclusive) of Trading Charges. This is because Interim Information Settlement Run data used in the calculation of AEI by the Energy Contract Volume Aggregation Agent (ECVAA) originates with the Settlement Administration Agent (SAA) rather than the FAA. The SAA does not add VAT onto Trading Charges – the addition of VAT is carried out by the FAA when it issues invoices. As such, the Group agreed that the CAP definition within the Code would not require amendment under P170 as the estimation of outstanding Trading Charges within the Code operates on a net rather than a gross basis, and the VAT law change does not impact net Trading Charges.

It was further noted that the next scheduled review of the CAP is currently due, and that a paper will be taken to the 26 October 2004 meeting of the ISG setting forward recommendations on revisions to the CAP.

1.3.7.3 Payment Default

The Group considered the impact of Payment Default situations upon the P170 requirements.

Payment Default occurs on occasions where a Payment Party does not settle outstanding Trading Charges on its due Payment Date. In such circumstances, the Code prescribes how the FAA should address this shortfall, through use of the Credit Facility, the Non-paying BSC Debtor's Credit Cover or by reducing outward payments to BSC Creditors as appropriate. Where bad debts for Trading Charges remain outstanding two Working Days after the due Payment Date and the FAA has made a drawing on the Credit Facility that has yet to be repaid, the FAA will calculate Shortfall Amounts for each other Payment Party based upon its Default Share Amount.

The Group considered that in cases where payments to BSC Creditors should be reduced, this reduction should be with regard to the amount exclusive of VAT. It should be noted that this was seen as a clarification of the current principle rather than a change to it (the Code is currently silent on whether a net or gross reduction is required), and is consistent with the requirement for the BSC Clearer to balance on a net rather than gross basis discussed elsewhere in section 1.3.4 of this document.

1.3.7.4 Legal text

The Group considered the legal text at some length. At its first meeting, a walkthrough of proposed legal text was undertaken. The text was amended in line with Group review comments before issuing as an addendum to the industry consultation document.

The legal text was reviewed again at the Group's second meeting in the context of consultation responses. The Group directed further amendments to clarify areas identified as requiring changes by consultation respondents.

The Group has approved the draft legal text appended to this document.

1.4 Assessment of how the Proposed Modification will better facilitate the Applicable BSC Objectives

The Group believed that the principal benefit of P170 was that it would require each Party to indemnify the BSCCo and BSC Clearer against VAT liabilities or financial penalties that might arise from incorrect invoicing and VAT payments had it erroneously declared, or failed to declare, information that the BSCCo and BSC Clearer needed to determine whether UK prevalent rate VAT should be applied to its charges under the Code. The Group believes it would not be appropriate for this risk to be borne across all Parties through the funding share mechanism as this would result in Parties incurring costs to rectify errors for which they were blameless.

The Group further believed that the Code should clarify the treatment of VAT imbalances that will now be realised by the BSC Clearer. From 1 January 2005, any VAT imbalances experienced by the BSC Clearer will be accounted for to Customs and Excise by the BSCCo. This necessitates ongoing processes to transfer shortfalls or surpluses between the BSC Clearer and BSCCo in both day-to-day operational and Payment Default situations, as well as processes for the BSC Clearer to notify the BSCCo in advance of each Payment Date of the shortfall or surplus expected to arrive. The Group believed that it was appropriate that the Code should stipulate the obligations of both BSCCo and BSC Clearer in this regard, in order that Parties had visibility on how these cashflows would operate and to confirm that the liability for operational BSC Clearer VAT balancing rests with the BSCCo.

The Group further believed that the Code currently lacks robust obligations for Parties to provide sufficient relevant information to allow the correct application of VAT after 1 January 2005. As detailed in section 1.3.1 of this document, the Code currently only mandates the provision of VAT details once, upon accession to the Code. Furthermore, Parties are not under any Code obligation to confirm whether they are liable to UK VAT or not, either before or after accession. The lack of relevant obligations, if unaddressed, would mean that the provision of such information by Parties to the BSCCo would have to be upon a purely voluntary basis. The Group considered that the provision of relevant data to the BSCCo to allow the correct invoicing of charges accrued under the Code should be mandatory rather than voluntary, and that mandatory data provision would be easier to enforce, and therefore more efficient, for the BSCCo and FAA to administer than attempting an approach based upon voluntary compliance.

For the reasons outlined above, the Group reached a consensus view that the Proposed Modification will better facilitate Applicable BSC Objective (d), 'Promoting efficiency in the implementation and administration of the balancing and settlement arrangements'.

The Group also gave consideration to whether P170 would also better facilitate 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', in view of the opinion expressed by one consultation respondent that it would be better achieved.

It was noted that the reason put forward in support of the facilitation of (c) was that it would remove the risk of all Parties picking up costs relating to one Party erroneously declaring its liability to UK VAT, a rationale put forward by the Group and other consultation respondents as supporting the facilitation of (d). Whilst the Group agrees that the rationale given in support of P170 is a valid benefit, it believes that this suggests better facilitation of (d) rather than (c) as this perceived benefit relates to the promotion of efficiency in the implementation and administration of the balancing and settlement arrangements rather than the promotion of market competition. The Group believes that P170 would have neither a positive nor a negative effect on the facilitation of Applicable BSC Objective (c).

1.5 Modification Group's cost benefit analysis of Proposed Modification

The Group believed that P170 is a Code only change and that costs are therefore restricted to those required to implement revised legal text. These costs have been estimated by ELEXON as £600 (equating to two man days).

For the reasons outlined in section 1.4 of this document, the Group believes that P170 would better facilitate the achievement of Applicable BSC Objective (d) by promoting efficiency in the implementation and administration of the balancing and settlement arrangements. Putting a precise cash figure to such benefit has not been attempted. This is because there is no obvious model that could be used to determine the likelihood, and financial costs and penalties, of BSCCo and/or BSC Clearer failing to comply with VAT law based upon a purely voluntary provision of relevant VAT information by Parties (the approach that would have to be adopted were Code obligations left unchanged).

Although a precise cash benefit to P170 could not be calculated, the Group believes it is reasonable to expect that its benefits would exceed the costs of implementing revised legal text.

2 COSTS⁹

PROGRESSING MODIFICATION PROPOSAL

Meeting Cost	£ 1,000
Legal/expert Cost	£ 33,750
Impact Assessment Cost	£ 0
ELEXON Resource	40 Man days £ 7,000

IMPLEMENTATION COSTS

		Stand Alone Cost	P170 Incremental Cost	Tolerance
Service Provider¹⁰ Cost	Change Specific Cost	£ 0	£ 0	+/- 0% (£ 0)
	Release Cost	£ 0		+/- 0% (£ 0)
	Incremental Release Cost	£ 0	£ 0	+/- 0% (£ 0)
	Total Service Provider Cost	£ 0	£ 0	+/- 0% (£0)
Implementation Cost	External Audit	£ 0	£ 0	+/- 0% (£ 0)
	Design Clarifications	£ 0	£ 0	+/- 0% (£ 0)
	Additional Resource Costs	£ 0	£ 0	+/- 0% (£ 0)
	Additional Testing and Audit Support Costs	£ 0		+/- 0% (£ 0)
Total Demand Led		£ 0	£ 0	+/- 0%

⁹ Clarification of the meanings of the cost terms in this section can be found in annex 7 of this report

¹⁰ BSC Agent and non-BSC Agent Service Provider and software Costs

Implementation Cost				
ELEXON Implementation Resource Cost		2 Man days £ 600	2 Man days £ 600	+/- 10% +/- £ 60
Total Implementation Cost		£ 600	£ 600	+/- 10%

ONGOING SUPPORT AND MAINTENANCE COSTS

	Stand Alone Cost	P170 Incremental Cost	Tolerance
Service Provider Operation Cost	£ 0 per annum	£ 0 per annum	+/- 0% (£ 0)
Service Provider Maintenance Cost	£ 0 per annum	£ 0 per annum	+/- 0% (£0)
ELEXON Operational Cost	£ 0 per annum	£ 0 per annum	+/- 0% (£0)

3 RATIONALE FOR MODIFICATION GROUP'S RECOMMENDATIONS TO THE PANEL

The Group recommends that P170 should be approved as it would better facilitate Applicable BSC Objective (d), 'Promoting efficiency in the implementation and administration of the balancing and settlement arrangements', for the reasons set out in section 1.4 of this document.

The Group further recommends an Implementation Date of five Working Days after an Authority determination. It is believed that such a formula would be more appropriate than recommending a specific Implementation Date. The rationale for this is a belief that Code obligations should be introduced as soon as possible, preferably in advance of the changes to BSCP301 and FAA systems and processes that will take effect on 17 December 2004 as a result of the implementation of CP1078.

The Group recommends that the draft legal text appended to this document form the basis of that consulted upon in the Report Phase.

4 IMPACT ON BSC SYSTEMS AND PARTIES

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

4.1 BSCCo

No changes to BSCCo systems and processes have been identified as resulting from P170. It should be noted that changes to BSC systems and processes will be required to allow the correct settlement of charges incurred under the Code, but that these will be implemented by CP1078.

4.2 BSC Systems

No changes to BSC systems and processes have been identified as resulting from P170. It should be noted that changes to BSC systems and processes will be required to allow the correct settlement of charges incurred under the Code, but that these will be implemented by CP1078.

4.3 Parties and Party Agents

Parties will be impacted by the introduction of a number of Code obligations. These are summarised in section 5.1 of this document.

Due to the multi-national nature of many BSC signatories and the complexity of VAT law it is not necessarily the case that all Parties with UK signatory addresses will be liable to UK VAT under the Code or that all Parties with non-UK signatory addresses will not be liable to UK VAT under the Code. However, as a crude estimate, this may give some estimation of the numbers of Parties affected.

At the time of writing, 14 of the 197 BSC signatories (7%) have signatory addresses outside the UK.

This tallies reasonably closely with Customs and Excise estimates of numbers of businesses impacted by the VAT law change. Customs and Excise issued a Regulatory Impact Assessment in respect of the impact of the VAT law changes to the place of supply of gas and electricity in March 2004 (reference 4). This suggested that 15 non-UK businesses trading in UK power markets will no longer require UK VAT registration. It should be noted that this estimate was based upon a combined assessment of gas and electricity markets, although in general there is significant cross-over between electricity and gas market participants.

5 IMPACT ON CODE AND DOCUMENTATION

5.1 Balancing and Settlement Code

Parties should consult the legal text appended to this document for definitive changes in obligations under the Code, but in brief these may be summarised as:

- Each Party must notify BSCCo of relevant VAT information in accordance with BSCP301 to enable the BSCCo and BSC Clearer to charge and pay correct amounts in respect of VAT;
- Each Party must notify BSCCo as soon as it has actual knowledge that any such information may, will or has changed;
- BSCCo and the BSC Clearer would be given the entitlement, but not the obligation, to charge amounts in respect of VAT where they reasonably believe that any assumptions as to the VAT status declared by a Party is incorrect;
- FAA would notify the BSCCo on each Notification Date of expected VAT imbalances on the relevant Payment Date;
- Section N prescribes how the BSC Clearer and BSCCo should resolve any VAT imbalances, whether surplus or deficit, incurred by the BSC Clearer both in carrying out its day-to-day transactions and where Amounts in Default occur. The BSCCo will fund shortfall and receive surplus VAT imbalances;
- FAA to retain and on request grant the BSCCo access to relevant information to allow it to comply with applicable VAT legislation, and provide information required by Customs and Excise for such period as may be required by law;
- Each Party to indemnify BSCCo and BSC Clearer in respect of any VAT (including interest and penalties) which BSCCo or BSC Clearer becomes liable to pay, and any reduction in the amount

of VAT which BSCCo or BSC Clearer is entitled to recover, where a payment has not been increased in respect of VAT but should have been; and

- Each Party to indemnify BSCCo and BSC Clearer to the extent that BSCCo and BSC Clearer are not entitled to a credit for input tax in relation to a payment increased on account of VAT because it did not constitute the consideration for a taxable or deemed taxable supply.

5.2 Code Subsidiary Documents

No changes to Code Subsidiary Documents have been identified¹¹.

5.3 BSCCo Memorandum and Articles of Association

No changes to the BSCCo Memorandum and Articles of Association have been identified.

5.4 Impact on Core Industry Documents and supporting arrangements

No impacts upon Core Industry Documents and supporting arrangements have been identified.

6 SUMMARY OF CONSULTATIONS

There were six respondents to the consultation on P170, representing 47 Parties¹² and 0 non-Parties.

Consultation question	Respondent agrees	Respondent disagrees	Opinion unexpressed
Do you believe Proposed Modification P170 better facilitates the achievement of the Applicable BSC Objectives?	4 (44)	0	2 (3)
Do you believe there are any alternative solutions that the Modification Group has not identified and that should be considered?	0	5 (46)	1 (1)
Do you believe that Code obligations should be implemented and take effect a specified number of Working Days after an Authority determination?	2 (24)	0	4 (23)
Do you believe that Code obligations should be implemented a certain number of Working Days after an Authority decision but with a further period of a specified number of Working Days before these obligations take effect?	0	2 (24)	4 (23)
Do you have any comments on the draft legal text appended to the Consultation Document?	3 (27)	2 (19)	1 (1)
Does P170 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?	1 (15)	3 (21)	2 (11)

¹¹ It should be noted that the draft legal text contains an obligation on Parties to notify VAT information to BSCCo in accordance with BSCP301, 'Clearing, Invoicing and Payment'. Changes to BSCP301 are not necessitated by P170 as this document will be appropriately amended during the implementation of approved Change Proposal 1078.

¹² Please note that the proforma response provided by Centrica plc is on behalf of 10 Parties, not one as inadvertently indicated on the submission. These Parties are: British Gas Trading Limited; Accord Energy Limited; Centrica KL Limited; Centrica PB Limited; Regional Power Generators Limited; Centrica RPS Limited; Electricity Direct Limited; Centrica Barry Limited; Centrica Generation Limited; and Humber Power Limited.

Are there any further comments on P170 that you wish to make?	3 (27)	2 (19)	1 (1)
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6.1 Modification Group's summary of the consultation responses

6.1.1 Applicable BSC Objectives

The majority of respondents believe P170 better facilitates the Applicable BSC Objectives, with three referencing specific objectives. Two believe it better facilitates Applicable BSC Objective (d), with one providing the supporting rationale that it would enable the BSCCo to more effectively administer the balancing and settlement arrangements in respect of VAT and would prudently avoid the potential for costs resulting from erroneous declarations to be smeared across all Parties. One believes that Applicable BSC Objective (c) would be better facilitated, for the same reasons that had been given in support of Applicable BSC Objective (d). One respondent who neither supported nor rejected P170 indicated that access to Customs & Excise's full written agreement to the proposed model was a prerequisite to determining whether P170 would better facilitate the Applicable BSC Objectives. None of the respondents believed P170 would not better facilitate the Applicable BSC Objectives.

6.1.2 Alternative solutions

None of the respondents identified any alternative solutions that had not been identified and considered by the Modification Group. One respondent noted that any alternative solution would need to be agreed with Customs & Excise before market participants could be consulted. One respondent noted that the proposed solution has the provisional approval of Customs & Excise.

6.1.3 Implementation Approach

The majority of respondents neither supported nor rejected Code obligations being implemented and taking effect a specified number of Working Days after an Authority determination. It was noted by one of these respondents that the Implementation Date should be driven by the requirement to accommodate the law change. This point was reiterated by another respondent who identified 23 December 2004 as the latest acceptable Implementation Date.

The remainder of respondents supported Code obligations being implemented and taking effect a specified number of Working Days after an Authority determination. One suggested five Working Days would be appropriate, whilst noting the urgency of required changes. Another suggested five Working Days after an Authority decision or 23 December 2004, whichever is the later.

The majority of respondents also neither supported nor rejected Code obligations being implemented a certain number of Working Days after an Authority decision but with a further period of a specified number of Working Days before these obligations take effect. One respondent noted that the Implementation Date of P170 would need to take into account the implementation of CP1078.

The remainder of respondents rejected Code obligations being implemented a certain number of Working Days after an Authority decision but with a further period of a specified number of Working Days before these obligations take effect. One respondent commented that a delay between the introduction of Code changes and these obligations taking effect would introduce uncertainty and confusion about what happens on particular days and could prevent implementation occurring prior to the VAT law change. The respondent further noted that those Parties likely to be impacted by the VAT law change should already be aware of its implications and therefore able to act on relevant Code obligations quickly.

6.1.4 Legal text

Requests for clarifications or changes were made against the following clauses of the draft Section N legal text consulted upon: 2.7.1; 5.4.1; 5.4.10; 7.1.4; 9.6.9; and 10.1.1.

No comments were made against Section D changes.

6.1.5 Outstanding issues and further comments

Only one respondent provided comments on Question 6, re-iterating a view expressed elsewhere that VAT advice given to ELEXON should be made available to Parties on request and stating that VAT reporting requirements should be legally robust and also subject to review by Parties upon request.

Two respondents re-iterated concerns in their Question 7 responses that visibility on, and confirmation of, the scope of the written agreement with Customs and Excise should be relayed to Parties. One respondent further flagged up an issue with regard to Credit Assessment Price (CAP), which is used in the calculation of Energy Indebtedness, whilst acknowledging that addressing this issue was outside the scope of the P170 Modification Proposal.

6.2 Comments and views of the Modification Group

The Group concurred with the arguments put forward in support of P170 but believes these suggest it better facilitates only Applicable BSC Objective (d), rather than both Applicable BSC Objective (c) and (d). The Group does not believe that there is a persuasive case that P170 promotes competition in the generation, supply, sale or purchase of electricity and therefore regards the impact of P170 on Applicable BSC Objective (c) as neutral rather than positive.

The Group concurred that the BSCCo should take steps to publish the finalised agreement with Customs & Excise once received in order that Parties have visibility upon this.

The Group concurred with an approach of the Implementation Date being five Working Days after an Authority decision on the basis that P170 will be a Code only change and may be implemented outside a scheduled release. The Group agreed with those respondents who suggested that 23 December is a backstop decision date based upon that date being five Working Days before the VAT law change takes effect.

Although 23 December 2004 is identified as a backstop date, the Group favoured recommending an Implementation Date of five Working Days after an Authority decision rather than explicitly recommending an Implementation Date of 23 December 2004 itself. The rationale for this is a belief that Code obligations should be introduced as soon as possible, preferably in advance of the changes to BSCP301 and FAA systems and processes that will take effect on 17 December 2004 as a result of the implementation of CP1078. Specifying a precise Implementation Date would preclude an earlier implementation regardless of the timing of an Authority determination.

The Group agreed with the rationale put forward against obligations taking effect a number of days after the Implementation Date and does not believe this delay would be necessary or advisable.

The Group noted that concerns were raised against the following paragraphs of Section N contained within the red-lined legal text distributed with the Consultation Document: 2.7.1; 5.4.1; 5.4.10; 7.4.1; 9.6.9; and 10.1.1. The Group directed appropriate amendments and changes should be made to the legal text to ensure clarity in each of these provisions, and this updated legal text is appended to this document.

The Group noted that any changes to the format of VAT invoices contained within BSCP301 will fall under the auspices of BSCP40, 'Change Management', and will therefore be open to Party scrutiny. The Group additionally noted that ELEXON has been made aware of the requirements of the EC VAT

Invoicing Directive (2001/115/EC) by its auditors and will be mindful of this in delivering the changes required by CP1078.

The Group noted ELEXON advice that the treatment of Section D Charges will be clarified in the formal agreement that is reached with Customs and Excise. The Group noted that ELEXON has been advised by its auditors that a Party who will not be charged UK prevalent rate VAT upon its Trading Charges should also not be charged UK prevalent rate VAT upon its Section D Charges and this principle should be reflected within the formal agreement. The Group considers that the wording of the draft legal text for Section D is sufficiently flexible to work even were Customs and Excise to reject this approach on Section D Charges.

7 SUMMARY OF TRANSMISSION COMPANY ANALYSIS

7.1 Analysis

P170 does not impact on the ability of the Transmission Company to discharge its obligations under the Transmission Licence, and has no impacts upon its computer systems and processes, Core Industry Documents or development, capital and operating costs.

The Transmission Company is supportive of P170 meeting Applicable BSC Objective (d) as it would provide for a framework to ensure that both ELEXON and market participants are able to meet the obligations of the new European taxation legislation.

7.2 Comments and views of the Modification Group

The Group noted the views of the Transmission Company, but had no comments upon them.

8 IMPLEMENTATION APPROACH

The Group considered that P170 is a Code only change, and therefore may be implemented outside a scheduled release. The Group has recommended that the Implementation Date of P170 should be five Working Days after an Authority determination.

9 DOCUMENT CONTROL

9.1 Authorities

Version	Date	Author	Reviewer	Change Reference
0.1	30/09/04	Change Delivery	Sarah Parsons	MG Chair review
0.1	30/09/04	Change Delivery	P170 Modification Group	Modification Group review
0.2	05/10/04	Change Delivery	Sarah Parsons	Further technical review
0.2	07/10/04	Change Delivery	Alex Grieve	QA review
1.0	08/10/04	Change Delivery	BSC Panel	For Panel decision

9.2 References

Ref No.	Document Title	Owner	Issue Date	Version
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Ref No.	Document Title	Owner	Issue Date	Version
1	COUNCIL DIRECTIVE 2003/92/EC of 7 October 2003 amending Directive 77/388/EEC as regards the rules on the place of supply of gas and electricity. Http link: http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_260/l_26020031011en00080009.pdf	The Council of the European Union	11 October 2003	N/A
2	Initial Written Assessment for P170. Http link: http://www.elexon.co.uk/documents/modifications/170/81_004a_P170_IWA.pdf	ELEXON	27 August 2004	1.0
3	Assessment Consultation for P170. Http link: http://www.elexon.co.uk/documents/Consultations/P170_Assessment_Consultation/P170AC10.pdf	ELEXON	10 September 2004	1.0
4	Regulatory impact assessment for changes to the VAT rules on the place of supply of gas and electricity Http link: http://www2.hmce.gov.uk/forms/graphics/ria-gas-electricity.pdf	Customs and Excise	March 2004	N/A
5	Finance Act 2004, Part 2, Section 21: 'Reverse charge on gas and electricity supplied by persons outside UK' Http link: http://www.legislation.hmso.gov.uk/acts/acts2004/40012--c.htm#21	Act of Parliament (Crown Copyright)	2004	N/A

ANNEX 1 DRAFT LEGAL TEXT

Draft legal text is appended to this document as three separate attachments:

- Redlined version of amended Section N; and
- Redlined version of amended Section D.

ANNEX 2 MODIFICATION GROUP DETAILS

NAME	POSITION	MEMBER	MEETING ATTENDANCE	
			06/09/2004	29/09/2004
Sarah Parsons	Chairman	Y	Y	Y
Richard Hall	Lead Analyst	Y	Y	Y
Shelagh Spurway	Centrica plc	Y	Y	Y
Richard Pretlove	EDF Trading Ltd	Y	Y	Y

Rekha Patel	ConocoPhillips (U.K.) Limited	Y	Y	Y
Geoff Allen	E.ON UK plc	Y	Y	Y
Andrew Colley	Scottish and Southern Energy plc	Y	Y	Y
Barbara Vest	Gaz de France Energy Supply Solutions	N	Y	N
Steve Mackay	Ofgem	N	Y	Y
Charles Yorke	External legal advice (Denton Wilde Sapte)	N	Y	N
Jane Douglas	External legal advice (Denton Wilde Sapte)	N	N	Y
David Ahmad	Internal legal advice (ELEXON)	N	Y	N
James Pettit	Internal advice (ELEXON)	N	Y	N
Mike Jones	Internal advice (ELEXON)	N	N	Y

ANNEX 3 ASSESSMENT CONSULTATION RESPONSES

The responses to the Consultation Document issued during the Assessment Procedure are appended to this document as a separate attachment.

ANNEX 4 TRANSMISSION COMPANY ANALYSIS

Q	Question	Response
1	Please outline any impact of the Proposed Modification (and, if applicable, any Alternative Modification) on the ability of the Transmission Company to discharge its obligations efficiently under the Transmission Licence and on its ability to operate an efficient, economical and co-ordinated transmission system.	The proposed modification does not impact on the ability of the Transmission Company to discharge its obligations under the Transmission Licence.
2	Please outline the views and rationale of the Transmission Company as to whether the Proposed Modification (and, if applicable, any Alternative Modification) would better facilitate achievement of the Applicable BSC Objectives.	We believe that the proposed modification meets BSC Applicable Objective d) in promoting efficiency in the implementation and administration of the balancing and settlement arrangements. We would support the actions being taken by Elexon in raising this modification proposal to provide for a framework to ensure that both Elexon and participants are able to meet the obligations of the new European taxation legislation.

3	Please outline the impact of the Proposed Modification (and, if applicable, any Alternative Modification) on the computer systems and processes of the Transmission Company, including details of any changes to such systems and processes that would be required as a result of the implementation of the Proposed Modification (and, if applicable, any Alternative Modification).	No impact has been identified on the computer systems and processes of the Transmission Company.
4	Please provide an estimate of the development, capital and operating costs (broken down in reasonable detail) which the Transmission Company anticipates that it would incur in, and as a result of, implementing the Proposed Modification (and, if applicable, any Alternative Modification).	No costs have been identified.
5	Please provide details of any consequential changes to Core Industry Documents that would be required as a result of the implementation of the Proposed Modification (and, if applicable, any Alternative Modification).	No changes have been identified.
6	Any other comments on the Proposed Modification (and Alternative Modification if applicable).	None.

ANNEX 5 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:

PROGRESSING MODIFICATION PROPOSAL	
Meeting Cost	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.
Legal/expert Cost	This is the cost associated with obtaining external expert advice, usually legal advice.
Impact Assessment Cost	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.
ELEXON Resource	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 Procedures.

SERVICE PROVIDER¹³ COSTS

Change Specific Cost	Cost of the Service Provider(s) Systems development and other activities relating specifically to the Modification Proposal.
Release Cost	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.
Incremental Release Cost	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.

IMPLEMENTATION COSTS

External Audit	Allowance for the cost of external audit of the delivery of the release. For CVA BSC Systems Releases this is typically estimated as 10% of the total Service Provider Costs, with a tolerance of +/- 20%. 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.
Design Clarifications	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 5% of the total Service Provider Costs, with a tolerance of +/- 100%.

¹³ 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.

Additional Resource Costs	<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>
Additional Testing and Audit Support Costs	<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, 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.

ONGOING SUPPORT AND MAINTENANCE COSTS

ELEXON Operational Cost	Cost, in man days per annum multiplied by project average daily rate, of operating the revised systems and processes post implementation.
Service Provider Operation Cost	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.
Service Provider	Cost quoted in £ per annum payable to the Service Provider(s) to cover the maintenance of the amended BSC Systems.

Maintenance Cost	
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ANNEX 6 GUIDANCE NOTE ON THE IMPACT OF THE GAS AND POWER DIRECTIVE PREPARED BY DELOITTE AND TOUCHE LLP

Guidance Note on the Impact of the Gas and Power Directive

Background

Currently trading charges are treated for VAT purposes as being the consideration for a supply of electricity. Under the present VAT rules the electricity is treated as being supplied in the UK and each trading party is required to be registered for VAT in the UK. All charges are therefore subject to VAT. As the net amounts received and payable under the balancing mechanism are equal, the VAT amounts are also equal.

On 1 January 2005, new European rules will come into effect. Under these new rules, VAT will be chargeable according to where the recipient of the electricity is established and not where the electricity is at the time of sale. These changes are being introduced in the hope of simplifying the VAT compliance requirements for businesses in the electricity and gas industry.

Under the old rules, businesses were often required to maintain numerous VAT registrations across the various territories where they sold gas and electricity. In future it will be the customer's responsibility to account for VAT on supplies of wholesale gas and electricity when he is established in a different country to the supplier. The practical impact for Elexon is that payments made under the balancing mechanism to trading parties outside the UK will no longer be made with VAT added, and VAT will not be chargeable on payments made by these parties.

Although Elexon Clear is not registered for VAT, the confirmation notes issued served as sales and purchase invoices for trading parties. This has been allowed as the VAT totals are in balance; Under the new rules Elexon Clear would have either a surplus or a shortfall of VAT as the VAT amounts will no longer balance.

Proposed solutions

In the light of the concerns regarding the difficulties in dealing with the VAT accounting a number of different potential solutions were proposed to Customs:

1. Register all market participants for VAT
This was rejected as being incompatible with EU law.
2. Register Elexon Clear for VAT
Rejected as Elexon Clear is not a legal entity in its own right.
3. Average weighted VAT charge
This involves adjusting the rate of VAT charged to ensure that the amount is equal to that paid. A similar approach was used under the pool but this was rejected as being too complex.
4. Adjusting VAT via Elexon Limited
This involves either adjusting the VAT balance of Elexon Clear via Elexon Limited's VAT return, or treating Elexon Limited as an agent.

Outline of Customs' response to the proposals

In the light of the proposals, Customs have proposed that "Elexon Ltd be allowed to act as an agent in its own name to account for VAT incurred under the reverse charge using its current registration."

On a practical basis, this will mean the following in terms of Elexon's VAT accounting:

- By acting as agent, Elexon Limited would be treated as making sales and purchases of electricity that arise under the balancing mechanism. Since there will be a difference between the VAT incurred on the purchase of electricity and the VAT due on the sale of electricity, Elexon Limited will either recover VAT from Customs or make payment to Customs at the end of each VAT return period (whether this is a payment or refund would be subject to the location of the trading parties during the balancing period). This methodology involving Elexon Ltd acting as agent should solve the difficulty in dealing with the discrepancy between the level of VAT incurred and due under the balancing mechanism.
- We understand that this proposal would capture all supplies made under the balancing mechanism and not solely the difference between supplies made and received. In other words, Elexon Ltd will show all supplies under the balancing mechanism on its VAT return.
- This would mean that where a trading party is not established in the UK for VAT purposes and is treated as making a sale of electricity under the balancing mechanism, then Elexon Limited would self account for VAT under the reverse charge (i.e. as if it had made both the purchase and supply of the electricity). This procedure has no practical effect on Elexon Limited.
- Similarly where there are purchases of electricity under the balancing mechanism by trading parties that are not established in the UK, then Elexon Limited would treat this as a sale by Elexon Limited, which is outside the scope of UK VAT and accordingly no VAT would be accounted for on the sale.
- Under this proposal, we envisage that there should be almost no change in the way that the mechanism functions for the trading parties. That said, there will have to be some changes to the documentation requirements for overseas invoicing as invoices to parties established outside the UK but within the EU would need to comply with the requirements of the EU Invoicing Directive. We deal with this issue in further detail below.
- The proposal will be binding on all parties, including Customs, as the proposed changes will be subject to a new modification proposal as well as a revised agreement with the tax authorities.

Why this solution?

It is considered that this approach is the easiest to adopt. It falls within the principles of EU VAT law, and has minimal impact on trading parties. It is the easiest for Elexon to operate, and should be secure for the VAT authorities point of view. We anticipate that trading parties will welcome the proposal.

Practical Implications

However there are various practical implications:

1. **Time of supplies** – at present Elexon Clear calculates its balances on a half-hourly basis, meaning that there are 48 balancing periods in each daily period. Under the current time of supply rules for electricity the taxpoint is the earlier of payment or issue of an invoice. Since Elexon receives one daily payment and issues one daily document in relation to the 48 periods that arise each day under the balancing mechanism, there is at present one daily taxpoint for supplies under the balancing mechanism.

While the new legislation concerning the time of supply rules for electricity arising under the new place of supply rules has not been released, broadly, the tax point for electricity is likely to be the same as for services subject to the reverse charge (i.e. the tax point arises on the date of payment). On this basis, Elexon Ltd will be treated as making supplies on a daily basis arising from the daily payment made under the balancing mechanism.

2. **Confirmation of place of supply for trading parties** – it is our understanding that for the purposes of the new place of supply rules, the place where a business is established will depend on broadly the same criteria as those currently used for supplies to business established outside the UK and where the recipient must self-account for VAT. Clearly, Elexon would want to ensure the correct running of this system. On this basis, Elexon proposes to determine where a business is established for VAT purposes using the following approach:

- (i) **Certification** – Elexon will require trading parties to provide details of where they are established for VAT purposes via a certificate or some other written documentation.

- (ii) **Test of establishment** – In addition to certification, Elexon would make sure that it has a record of the EU VAT registration number for the trading party to which it will be making supplies and this will be used on the VAT documentation, which we discuss further below. This test would not function when applied to non-EU established traders and Customs will provide guidance on this point shortly.

3. **Documentation** – In the past, Elexon has had detailed discussions with Customs regarding the requirements for invoicing and in the light of these discussions has agreed with Customs that certain documents may qualify as VAT invoices. It is intended that Elexon Ltd would be permitted to carry on invoicing using the same documentation for domestic supplies of electricity. However, as outlined above, the new rules regarding the place of supply will have an effect on the format of all documents provided to trading parties established in the EU and outside the UK.

Elexon propose to continue to issue documentation to trading parties as it has done before. In addition, Elexon would also issue a monthly summary VAT invoice to overseas trading parties, which would adhere to the Invoicing Directive. This would include the VAT registration number of the overseas trading party.

Under UK legislation there is a requirement to issue a VAT invoice within 30 days of a supply. On this basis, we propose that Elexon will raise the monthly document to non-UK trading parties established in the EU, which will summarise the supplies for each monthly period.

While this monthly document will be the evidence for VAT purposes of supplies made, on a day-to-day basis, the current documentation system will still be able to function.

ANNEX 6 TERMS OF REFERENCE FOR THE GROUP

The Group was given the following Terms of Reference by the Panel:

- consider what obligations exist for a Party to declare its VAT status;
- consider whether a Party should hold financial responsibility for an erroneous declaration of VAT details;
- consider the definition of VAT within the Code;
- consider how deficits or surpluses of VAT should be accounted for between the BSCCo and the BSC Clearer;
- consider the interrelation between P170 and CP1078; and
- consider how Section D Charges are impacted by the Directive.

ANNEX 7 SETTLEMENT OF VAT IMBALANCES BY THE BSCCO

The legal text contains a number of provisions to explain how the BSC Clearer will cater for VAT imbalances. To explain how this will work in practice:

In relation to normal payments (ie where Trading Charges are settled on the due Payment Date):

When the FAA calculates each Party's due Trading Charges in relation to a given Payment Date, it will also calculate the overall shortfall or surplus of funds that it expects will result from the VAT imbalance for that Payment Date.

The FAA is under an existing obligation to notify Parties of due payments in relation to a given Payment Date on each Notification Date. P170 would introduce obligations under proposed new clauses **N2.7.3** and **N7.1.4** for the FAA to also notify the BSCCo of the expected shortfall or surplus and for the BSCCo to fund BSC Clearer cash shortfalls and receive BSC Clearer cash surpluses resulting from VAT imbalances.

In relation to Amounts in Default (ie where Trading Charges are not settled on a due Payment Date by a Party or Parties):

Where a further (unexpected) VAT shortfall arises as a result of Payment Default, and this debt remains outstanding two Working Days after the due Payment Date, the BSCCo shall pay this outstanding amount in respect of VAT to the BSC Clearer under proposed new clause **N9.6.9**, in order that the BSC Clearer may repay the Credit Facility for such funds borrowed in respect of an outstanding amount due as VAT. It should be noted that this payment is purely to allow the BSC Clearer to balance its VAT position and does not discharge the debt the Party has for Trading Charges.