

## **ASSESSMENT REPORT for Modification Proposal P146 New Participation Category to the BSC – Clearing House**

**Prepared by: Settlement Standing Modification Group**

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

### **RECOMMENDATIONS**

The SSMG invites the Panel to;

- **AGREE that the Alternative Modification P146 should be made;**
- **AGREE that the Proposed Modification P146 should not be made;**
- **AGREE a provisional Implementation Date for the Alternative Modification P146 of 3 November 2004 if an Authority Decision is received on or before 27 July 2004, or 23 February 2005 if an Authority Decision is received after 27 July 2004 but on or before 16 November 2004;**
- **AGREE a provisional Implementation Date for the Proposed Modification P146 (in the event that the Authority determines that the Proposed Modification should be made) of 23 February 2005 if an Authority Decision is received on or before 22 June 2004, or 29 June 2005 if an Authority Decision is received after 22 June 2004 but on or before 28 October 2004;**
- **AGREE that Modification Proposal P146 be submitted to the Report Phase;**
- **AGREE that the draft Modification Report be issued for consultation and submitted to the Panel Meeting of 11 March 2004;**
- **NOTE that draft legal text has been provided for the Alternative Modification;**
- **NOTE that no legal text has been provided for the Proposed Modification; and**
- **CONSULT with the Authority as to whether such text is required.**

<sup>1</sup> The current version of the Balancing and Settlement Code (the 'Code') can be found at [www.elexon.co.uk/ta/bscresl\\_docs/bsc\\_code.html](http://www.elexon.co.uk/ta/bscresl_docs/bsc_code.html)

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### SUMMARY OF IMPACTED PARTIES AND DOCUMENTS

As far as BSCCo and the SSMG have been able to assess, the following parties/documents would be impacted by the implementation of the Proposed Modification P146 and/or the Alternative Modification P146.

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

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

## 1.1 Modification Proposal

Modification Proposal P146 ('P146') was raised by OM London Exchange Ltd ('the Proposer') on 3 November 2003.

### 1.1.1 Issue/Defect which Modification Proposal seeks to Address

Currently, organisations which operate as Clearing Houses in the electricity market are required to register as Trading Parties under the Balancing and Settlement Code ('the Code'), since they hold Energy Accounts in order to act as the central counterparty and notifier to trades between their members.<sup>2</sup> P146 argues that this requirement represents a defect in the Code through a failure to recognise that Clearing Houses operate a different market position to other BSC Trading Parties. The Proposer of P146 states that Clearing Houses are subject to their own regulatory requirements, do not hold gross positions in power contracts,<sup>3</sup> and do not seek to profit from price changes. P146 argues that membership of a Clearing House allows BSC Parties to trade at the 'best price' available without concerns over the credit-worthiness of their counterparties, because each Clearing House takes responsibility for the credit risk and performance of the contracts they clear.

P146 therefore suggests that the Code should seek to recognise, facilitate and enhance the role of Clearing Houses since such organisations increase the efficiency and transparency (and therefore the competitiveness) of the sale and purchase of electricity. The Proposer therefore believes that P146 would better facilitate Applicable 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.

Specifically, P146 seeks to amend the Code to create a new participation category of 'Clearing House', mitigate the risk to Clearing Houses of their counterparties entering Credit Default, and correct a perceived discrimination in the Notified Volume Charges applied to Clearing Houses.

### 1.1.2 Solution Proposed by P146

The three components of the Modification Proposal are outlined in more detail below.

#### (a) New Category of 'Clearing House'

P146 seeks to introduce a new category of 'Clearing House' into Section A of the Code. Within this category Clearing Houses would be able to submit Energy Contract Volume Notifications (ECVNs or 'notifications') for their cleared trades in the role of an Energy Contract Volume Notification Agent (ECVNA) as currently, but would not be authorised to act in any other participation capacity.<sup>4</sup> However, those Parties registering as Clearing Houses would receive two unique benefits as described in (b) and (c) below.

#### (b) Notification of Potential Credit Defaults from the ECVA to Clearing Houses

The Modification Proposal argues that the Code's inability to facilitate the operation of Clearing Houses is manifest in the inability of the Energy Contract Volume Aggregation Agent (ECVAA) to supply information to such organisations in the event of the potential Credit Defaults of their members. By

<sup>2</sup> Annex X-1 of the Code currently defines a Trading Party as 'a Party, other than the Transmission Company, which holds Energy Accounts'.

<sup>3</sup> The Proposer argues that Clearing Houses always seek to hold an aggregate contract volume of zero (hereafter referred to as a 'net' position of zero).

<sup>4</sup> This would not constrain the ability of such Parties to act as Market Index Data Providers (MIDPs) under the Code, since MIDPs represent a service provider role rather than a participation capacity.

acting as the central counterparty to their members' trades and guaranteeing delivery, the Clearing House bears the non-delivery risk normally involved in a bilateral trade between Parties. P146 argues that, as clearing facilitates competition by removing this exposure for Parties, the Code should act to protect Clearing Houses from such risks in return. Specifically, P146 seeks to mitigate the potential imbalance risk to a Clearing House of any of its members becoming unable to deliver part of a cleared trade due to having been placed in Credit Default under the Code and thereby having triggered notification rejections. The Modification Proposal therefore seeks to add a Code obligation, within the Section M Credit Default process, for the ECVA to provide warning to a Clearing House of any members in breach of their Credit Cover Percentage. This provision would be applied to any Parties for whom the Clearing House was authorised to submit ECVNs.

### **(c) Single Notified Volume Charge for Clearing Houses**

P146 states that another area in which the Code fails to recognise the role of Clearing Houses is in the charging schedule applied to notified energy volumes. The Proposer argues that the Notified Volume Charge, which is currently applied to all Trading Parties by total notified energy volume, discriminates against Clearing Houses. By acting as the central notifying counterparty to all their cleared positions (the buyer to every seller and the seller to every buyer), Clearing Houses submit two notifications for the actual volume traded – an equal and opposite buy for every sell.<sup>5</sup> Such Parties therefore receive twice the level of notification charges due to this 'doubling' of ECVNs. The Modification Proposal therefore seeks to amend Section D, Annex D-3 of the Code so that those Parties registered within the new capacity of Clearing House would only be charged once per traded volume, although Clearing Houses would continue to notify the volume twice as the central counterparty. The Proposer argues that this should be achieved by invoicing Clearing Houses for Notified Volume Charges relating to positive energy volumes only.

#### **1.1.3 Process Followed to Date**

The P146 Initial Written Assessment was presented to the BSC Panel at its meeting of 11 November 2003, where the Panel determined that the Modification should be submitted to a three-month Assessment Procedure by the Settlement Standing Modification Group (SSMG) supplemented with expertise from the Governance Standing Modification Group and non-physical traders. The issues raised by BSCCo and the Panel during the Initial Assessment of P146 formed the basis of the SSMG's Terms of Reference, and can be found in Annex 2 along with details of the Group's membership.

The SSMG met four times during the Assessment Procedure to consider P146: on 18 November 2003, 2 December 2003, 16 December 2003 and 13 January 2004. A summary of the SSMG's discussions and recommendations is provided in Sections 1.2-1.8. An industry consultation was issued and impact assessments commissioned from the BSC Agent, BSC Parties, Party Agents, Core Industry Document Owners and BSCCo – and summaries of the views and impacts returned can be found in Sections 2, 4, 5, and 6, with the full responses attached as Annexes 3-5. Draft legal text has been provided for the Alternative Modification, and is attached as Annex 1.

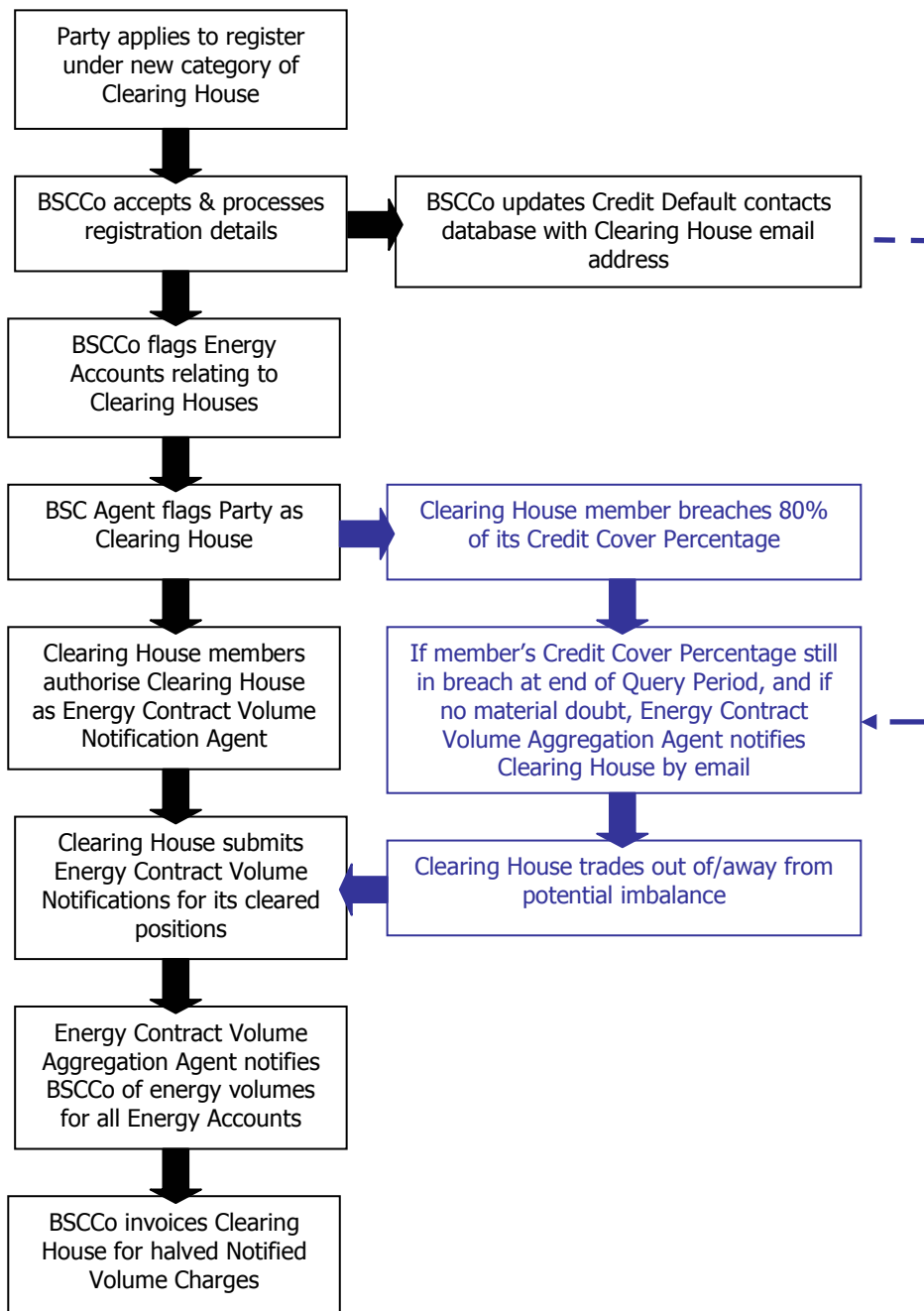
## **1.2 Proposed Modification**

Figure 1 on the following page provides a high-level overview of the solution developed by the SSMG to support the Proposed Modification.

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<sup>5</sup> For example, where a Clearing House notified a trade of 100 MW from Party A to Party B with itself as the central counterparty the Clearing House would be charged for the total notified energy volume of 200 MW (see Figure 3).

**Figure 1 – Overview of Proposed Modification**



Summaries of the new processes which would result from the implementation of this solution are given below.

**1.2.1 New Category of 'Clearing House' – Semi-Manual Solution**

- The new Code category of Clearing House would be created as a sub-category of the current Trading Party participation capacity.
- Within this sub-category, Clearing House Parties would continue to hold the same rights and obligations as Trading Parties, subject to the following criteria:

- The registering Party must hold one of the following types of recognition status from the Financial Services Authority under the Financial Services and Markets Act 2000 (FSMA): Recognised Clearing House (RCH) or Recognised Investment Exchange (RIE);
  - If a RIE, the Party must provide a central counterparty clearing service within the electricity market as part of its business activities;
  - The Party shall not seek to trade or hold gross positions in electricity contracts, but shall seek to hold a net position of zero at all times;
  - The Party may not hold BM Units; and
  - The Party must operate independently from any Party trading or holding gross positions under the Code, or which holds BM Units.
- Organisations wishing to register within the new category would be required to undertake a self-certification Market Entry process, by providing BSCCo with evidence of their status as a RCH/ROCH or RIE/ROIE and by completing a signed undertaking to meet the above entry criteria.
  - As part of its registration details, each Clearing House Party would provide BSCCo with an e-mail address to be used by the ECVAA to notify the Clearing House of the potential Credit Defaults of its members.
  - BSCCo would notify the Central Registration Agent (CRA) of each new Clearing House Party, and add the e-mail address to be used for Credit Default notifications to that Party to the Credit Default contacts database.
  - The CRA would add a new market role code to the Party ID of each Party registering within the new category, which would be transferred to the ECVAA using existing registration flows.
  - Each Clearing House Party would be obliged to notify BSCCo if, at any time, it became aware of any reason why it could no longer comply with the entry criteria for Clearing Houses. No formal monitoring to enforce Clearing Houses' compliance with the criteria would be undertaken by BSCCo.

The SSMG's rationale for adopting a semi-manual implementation option for the new Clearing House category is provided in Section 1.3. The Group's discussions regarding the entry criteria to be applied to Clearing Houses under P146 can also be found in Section 1.3.

### **1.2.2 Notification of Potential Credit Defaults – Semi-Manual Solution**

- Upon a Party breaching 80% of its Credit Cover Percentage, the ECVAA would run a system search to identify if the Party concerned had any ECVNA Authorisations with a Clearing House.
- The ECVAA would advise BSCCo of any such authorisations as an addition to the current process for informing BSCCo of the breach.
- Where the Party's redetermined Credit Cover Percentage remained above 80% at the end of a Query Period, BSCCo would instruct the ECVAA to notify the relevant Clearing House providing that:
  - Material doubt had not been queried by the end of the Query Period; or
  - Material doubt had been queried and declined by the end of the Query Period.

Where material doubt had been queried and upheld, or was still being investigated at the end of the Query Period, BSCCo would instruct the ECVAA not to notify the Clearing House. This



instruction would be an addition to the current process whereby the ECVAA notifies BSCCo of a Party's redetermined Credit Cover Percentage at the end of a Query Period.

- If instructed to provide notification to a Clearing House, the ECVAA would generate and send an e-mail to the address contained in the Credit Default contacts database.
- The e-mail notification would provide a Clearing House with the following information:
  - The name of the Party in breach for which the Clearing House held an ECVNA Authorisation; and
  - Notification that the Party concerned was still in breach of its Credit Cover Percentage at the end of a Query Period.

The exact percentage of the Party's breach (or whether it represented a Level 1 or Level 2 breach) would not be notified.

The SSMG's rationale for adopting a semi-manual implementation option for the Credit Default aspect of P146 is provided in Section 1.3. The Group's discussions regarding the timing of the notification, the conditions regarding material doubt, and the information to be provided can also be found in Section 1.3.

### **1.2.3 Single Notified Volume Charge for Clearing Houses – Manual Solution**

BSCCo would halve the Notified Volume Charges to be invoiced to each Party registered as a Clearing House under the Code. No Central Systems changes would be required as part of this new process.

The SSMG's rationale for adopting a manual solution for the charging aspect of P146 is contained in Section 1.3.

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

### **1.3.1 SSMG's Clarification of Participation Category**

The SSMG noted that the Modification Proposal seeks to introduce a new 'participation category', which is not a Code-defined term. The Group therefore queried whether the Proposer's intention was to create a new participation capacity under Section A, as this would require amendment to the current Code definition of Trading Party in order to exclude Clearing Houses. The Group noted that the Code currently contains approximately 600 references to Trading Party/Parties, and that these would have to be examined during the production of legal text to identify whether they should also refer to the new participation capacity of Clearing House. The Proposer clarified that the intent of P146 was to amend the current Section A participation capacities in order to recognise the role of Clearing Houses as a distinct form of market participation, but that this could be achieved either as a separate participation capacity or as a sub-category of Trading Party. The Group and the Proposer therefore agreed that Clearing Houses should be established as a subset of the current Trading Party capacity since this represented the most practical solution.

### **1.3.2 SSMG's Clarification of 'Clearing House' Definition**

The SSMG asked the Proposer to clarify the difference between a 'clearing house' and a 'power exchange', noting that UKPX (UK Power Exchange, part of OM London Exchange Ltd) currently provides both clearing and exchange services. The Proposer clarified that a pure exchange function provides a platform for the matching of buyers with sellers, who pay a fee for using the platform. The Proposer stated that the exchange's neutral market place represents a trade matching service (and thus provides the service that creates the trade) whilst an organisation providing a clearing service notifies the actual cleared trade. By acting as the central counterparty to the trade, the clearing organisation absorbs the

risk of non-delivery for the buyer and seller by making the notifications and guaranteeing the contract. In return, organisations offering clearing services hold collateral (or 'margin') from their members.<sup>6</sup>

The Proposer advised that, in practice, organisations like UKPX might provide both exchange and clearing services – and, indeed, might be required to do so (see below).

### **1.3.3 SSMG's Clarification of FSA Regulation**

Neither the Proposer nor the other members of the SSMG were able to identify any existing FSA definition of 'clearing' or 'Clearing House' which could be appropriated for the purposes of the Code under P146. Although the Proposal states that organisations wishing to register under the Code as Clearing Houses should be licensed and regulated by the FSA or an overseas national regulatory body, the Group also noted that the FSA does not license organisations as such but grants recognition statuses under the FSMA. The Group noted that there were two kinds of recognised body under the FSMA that could include clearing activities:

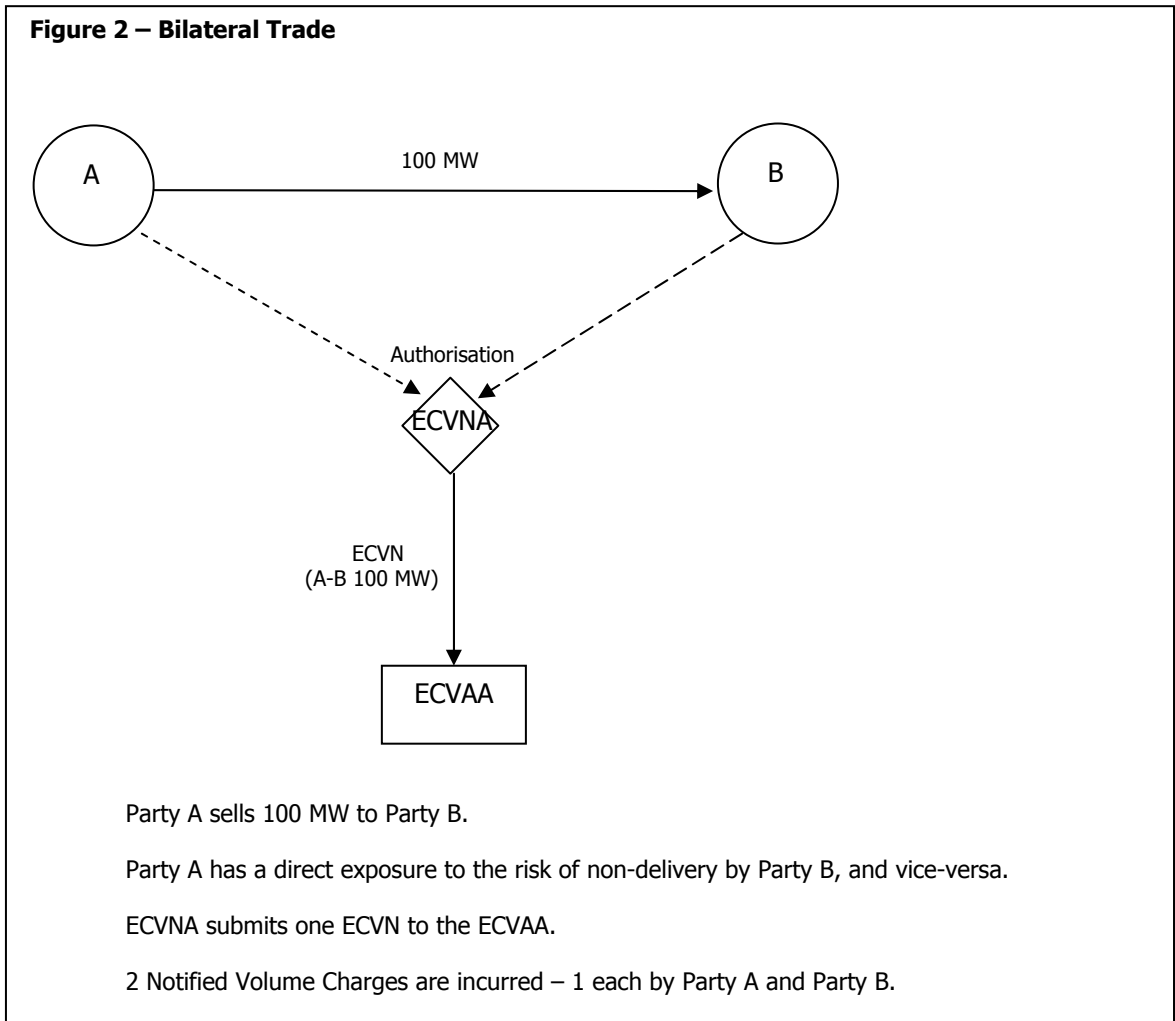
- A Recognised Clearing House (RCH) – being an organisation which is prevented from running an exchange and only authorised to provide clearing services. A RCH may provide clearing services to trades matched via an exchange, or to any Party and counterparty wishing to clear their trade (known as 'over-the-counter' or 'OTC' clearing).
- A Recognised Investment Exchange (RIE) – being an exchange that also offers clearing services. The FSMA requires that RIEs either offer their own clearing services or use a RCH for that purpose. RIEs operating their own clearing arrangements may also provide a clearing service to other exchanges, or to any Party and counterparty wishing to clear their trade.

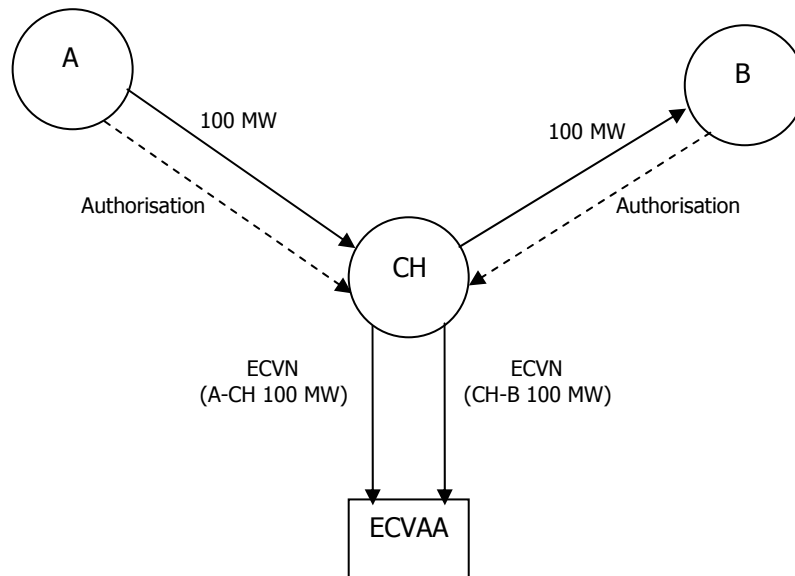
The SSMG noted that OM London Exchange is a Recognised Investment Exchange under the FSMA. The Group agreed that the new Code category of 'Clearing House' should include both RCHs and those RIEs (such as OM London) who provide their own clearing activities for either some or all of their members' trades. RIEs who solely use other organisations to provide clearing services would therefore not be included, since these would not be subject to the non-delivery risk involved in acting as the central counterparty to trades.

Figures 2-4 on the following pages outline the differences between a bilateral trade, a cleared trade, and a matched and cleared trade.

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<sup>6</sup> Although Clearing Houses mitigate the non-delivery risk involved in a trade, both buyer and seller are still required to lodge Credit Cover under the Code in addition to the margin held by the Clearing House.



**Figure 3 – Cleared Trade**

Party A and Party B bring their trade to the Clearing House to be cleared.

Clearing House becomes the central counterparty to the trade.

Party A sells 100 MW to Clearing House – Clearing House sells 100 MW to Party B.

Clearing House holds net position of zero.

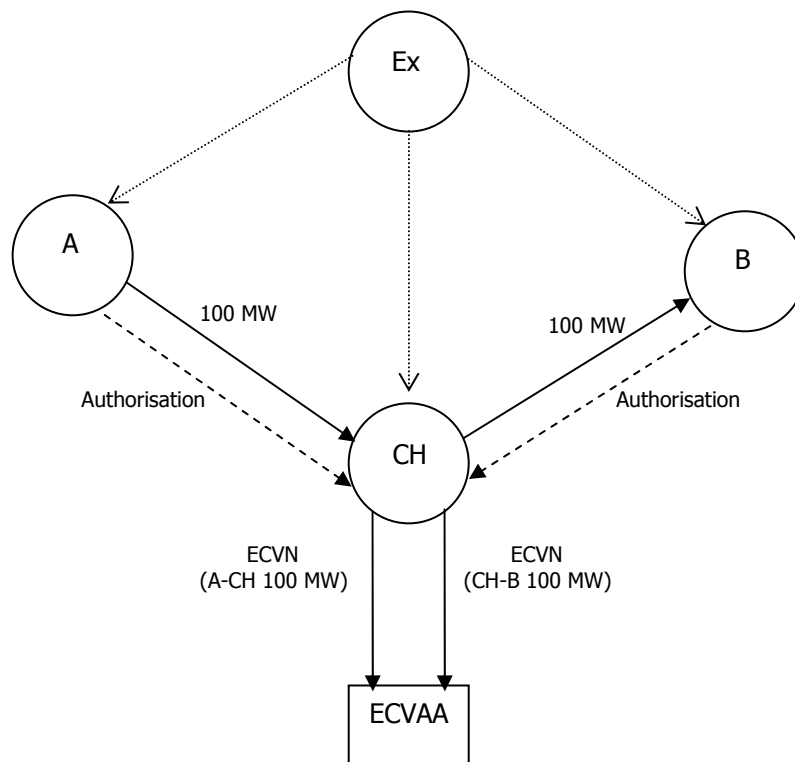
Clearing House acts as an ECVNA and submits two ECVNs to the ECVA.

4 Notified Volume Charges are incurred – 1 each by Party A and Party B, and 2 by the Clearing House.

Party A has no exposure to the risk of non-delivery by Party B, and vice-versa.

Clearing House has direct exposure to the risk of non-delivery by Party A and/or Party B.

Party A and Party B lodge margin with Clearing House.

**Figure 4 – Matched and Cleared Trade**

Exchange matches Party A (wishing to sell) with Party B (seeking to buy).

Party A and Party B pay a fee to the exchange for the matching service.

Either: Exchange brings trade to the Clearing House to be cleared, or  
Exchange and Clearing House are the same organisation.

Clearing House becomes the central counterparty to the trade.

Party A sells 100 MW to Clearing House – Clearing House sells 100 MW to Party B.

Clearing House holds net position of zero.

Clearing House acts as an ECVNA and submits two ECVNs to the ECVAAs.

4 Notified Volume Charges are incurred – 1 each by Party A and Party B, and 2 by the Clearing House.

Party A has no exposure to the risk of non-delivery by Party B, and vice-versa.

Exchange has no exposure to the risk of non-delivery by Party A or Party B, unless it is also the Clearing House.

Clearing House has direct exposure to the risk of non-delivery by Party A and/or Party B.

Party A and Party B lodge margin with Clearing House.

The SSMG also questioned the Proposal's apparent reference to recognition by overseas regulators, and expressed concern that their requirements might be different to, or inconsistent with, those of the FSA. The Group noted, however, that overseas investment exchanges or clearing houses wishing to undertake regulated activities in the UK are required to achieve the status of RCH or RIE under the FSMA.

The SSMG recognised that there may be other organisations which are subject to more general regulation under the FSMA, and which may provide clearing services as BSC Parties. All firms engaged in 'regulated activities' within the UK are required to be either authorised by the FSA, exempt from authorisation, or authorised by an equivalent regulator in the European Economic Area. Regulated activities include most financial products or services and examples include mortgages, life insurance, unit trusts and shares. As at July 2003, around 10,000 firms were regulated by the FSA – including 7,500 investment firms, over 660 banks, around 70 building societies, almost 1,000 insurance companies and around 700 credit unions.<sup>7</sup> BSC Trading Parties or their subsidiaries may also be regulated by the FSA where the agreements traded by such Parties under the Code fall within the area of investment activities.

One member of the Group advised that APX Amsterdam Power Exchange (UK) Limited (APX) currently represents an example of an authorised firm which also undertakes clearing activities as a BSC Party. APX acts in the role of an 'arranger', defined within the FSA Handbook's Glossary as 'a person who is arranging (bringing about) deals in investments, making arrangements with a view to transactions in investments or agreeing to carry on any of those regulated activities'.<sup>8</sup> Although arrangers are subject to rules concerning the neutrality of their matching service, they are not required to comply with the more detailed criteria for RCHs and RIEs. The key difference between the recognition requirements of RCHs and RIEs (as recognised bodies) and the rules for authorised firms is the obligation for recognised bodies to ensure the regulation of their markets and clearing services to appropriate standards – including regulation of their members' conduct through their own contracts.

The table below provides more detail regarding the differences between the regulatory requirements for recognised bodies and authorised firms under the FSMA.

	<b>Recognised Body</b>	<b>Authorised Firm</b>
Regulation	<p>Required to regulate conduct of own members, subject to FSA oversight. Rules must be subject to government scrutiny.</p> <p>Must fund necessary resource to regulate its members' trading activities.</p> <p>Required to share regulatory information with other recognised bodies and the FSA.</p> <p>In undertaking regulatory role, has statutory immunity from legal action by members for any losses.</p>	<p>Subject to FSA regulation regarding general business conduct and disclosure rules.</p> <p>No requirement to monitor client trading activities.</p> <p>No specific rules regarding information sharing, but must co-operate with the FSA.</p>
Capital adequacy	Required to have sufficient resources for performance of its functions.	Required to have capital to cover risks associated with its business.
Trade	Required to guarantee performance of trades.	No requirement to guarantee trades, but general obligations regarding business conduct and

<sup>7</sup> Figures obtained from the FSA website Media Centre at [http://www.fsa.gov.uk/media\\_centre/historical\\_timeline.html](http://www.fsa.gov.uk/media_centre/historical_timeline.html).

<sup>8</sup> See [http://www.fsa.gov.uk/handbook/hbk\\_glossary.pdf](http://www.fsa.gov.uk/handbook/hbk_glossary.pdf).

Recognised Body		Authorised Firm
performance	Required to have rules to deal with member default.	counterparty risks.  Required to hold capital against the risk of member default, but no requirement for default rules.

The SSMG therefore discussed whether arrangers should be allowed Clearing House status in the Code under P146. The majority of the Group considered that, since the FSA definition of 'arranger' does not specifically reference clearing activities, no justification could be made for the inclusion of arrangers to the exclusion of other authorised firms. Some Group members therefore suggested that the Code category of Clearing House should be expanded to include any authorised firms providing a de-facto clearing service within the UK electricity market. However, one member stated that – although the definition of 'arranger' does not reference clearing activities – arrangers are not authorised to deal, or profit from trades. This member considered that there would be no reason for an arranger to register as a BSC Party unless they were undertaking a clearing service, since providing a matching service to buyers and sellers could be operated outside of the Code. An arranger which additionally acted as an ECVNA (but not as a Clearing House) would be required to register as a Party Agent but not as a BSC Party. This member therefore argued that arrangers could be included as Clearing House Parties under the Code without also including other authorised firms. However, the SSMG were unable to locate the FSA's requirement that arrangers should not seek to profit from trades or price movements. The Group also considered that restricting the new category to RCHs, RIEs and arrangers could exclude other types of authorised firms which, although perhaps not currently offering clearing services, were not precluded from doing so by the FSMA. The SSMG noted that the inclusion of authorised firms more generally could capture all organisations with the potential to offer clearing services.

The SSMG also noted that the FSA currently plans to introduce a new authorised role of 'alternative trading system' (ATS) in April 2004, and that some organisations (such as APX) who currently operate as arrangers could qualify to act in this role. The draft FSA requirements for an ATS require the provision of satisfactory clearing and settlement arrangements, as well as monitoring and regulating client compliance with trading rules – and the category is currently intended to create a new kind of authorised firm which matches buyers and sellers, but is not a RIE. Some members of the SSMG therefore argued that the new category of Clearing House under the Code should consist of RCHs, RIEs and ATSS since these draft requirements reference clearing activities. However, the Group agreed that it was not possible to assess the merits of specifically including ATSS, since the category and its requirements remain subject to change (the P146 Modification Report being scheduled for submission to the Authority in March 2004). The SSMG noted that widening P146 to authorised firms more generally would incorporate the new authorised role of ATS if introduced.

The SSMG considered that there may be circumstances where a RCH/RIE, arranger or other authorised firm also provided a 'normal' ECVNA service in addition to its exchange and/or clearing functions, and as part of its wider business activities. The Group noted that, in respect of P146's Credit Default provisions, it would not be possible for the ECVA to know which ECVNA Authorisations related to clearing or to usual ECVNA activities. The SSMG therefore recognised that P146 could potentially lead to Clearing House Parties under the Code receiving early Credit Default information for Parties for whom they were authorised to act as an ECVNA, but who were not receiving a clearing service. The Group agreed that, although it did not wish to prevent such organisations acting as an ECVNA per se, the entry criteria for Clearing Houses under P146 should ensure that the benefits of the Modification were received only for cleared trades.

The SSMG also recognised that it might be theoretically possible for a Clearing House to act as the central counterparty to trades (matched on an exchange or otherwise) but not to notify the trade itself

and instead use another ECVNA to submit 2 ECVNs – one for each half of the trade with the Clearing House as the central counterparty. The Group noted that organisations using this practice would receive the benefit of halved Notified Volume Charges under P146 (reflecting their central counterparty role), but not early warning of their members' Credit Defaults since these provisions are linked to ECVNA authorisations.

#### **1.3.4 SSMG's Discussion of Appropriate BSC Entry Criteria for Clearing Houses**

The SSMG therefore developed the following series of options for the entry criteria which could be applied to the new Clearing House sub-category of Trading Party. In all cases, Clearing House Parties would continue to hold the same obligations and rights as Trading Parties – subject to the additional specified criteria.

##### **Option 1 – RCH/RIE plus Code Criteria**

- The Party must be either a RCH or a RIE providing a central counterparty clearing service within the electricity market as part of its business activities;
- The Party shall not seek to trade or hold gross positions in electricity contracts, but shall seek to hold a net position of zero at all times;
- The Party may not hold BM Units; and
- The Party must operate independently from any Party trading or holding gross positions under the Code, or which holds BM Units.

##### **Option 2 – Recognised Body or Authorised Firm plus Code Criteria**

- The Party must be either a recognised body under the FSMA or an authorised firm regulated by the FSA;
- The Party must provide a central counterparty clearing service within the electricity market as part of its business activities;
- The Party shall not seek to trade or hold gross positions in electricity contracts, but shall seek to hold a net position of zero at all times;
- The Party may not hold BM Units; and
- The Party must operate independently from any Party trading or holding gross positions under the Code, or which holds BM Units.

##### **Option 3 – Code Criteria Only**

- The Party must provide a central counterparty clearing service within the electricity market;
- The Party shall not seek to trade or hold gross positions in electricity contracts, but shall seek to hold a net position of zero at all times;
- The Party may not hold BM Units; and
- The Party must operate independently from any party trading or holding gross positions under the Code, or which holds BM Units.

##### **Option 4 – RCH/RIE Only**

- The Party must be either a RCH or a RIE providing a central counterparty clearing service within the electricity market as part of its business activities. No other criteria would be applied.



### **Option 5 – Recognised Body or Authorised Firm Only**

- The Party must be either a recognised body under the FSMA or an authorised firm regulated by the FSA, and must provide a central counterparty clearing service within the electricity market as part of its business activities. No other criteria would be applied.

The SSMG agreed that none of the above criteria should constrain the ability of clearing organisations such as APX and UKPX to additionally act as Market Index Data Providers.

The SSMG noted BSCCo's concern that it could not confidently regulate the criteria proposed for Clearing Houses. Since BSCCo does not hold detailed information regarding Parties' ownership structure it would therefore not be able to ensure Clearing Houses' independence from other Trading Parties. A requirement to monitor Clearing Houses to ensure that such Parties always held a net position of zero would also create a significant administrative burden for BSCCo and could require a new assurance process. The SSMG did not reach agreement regarding how a Clearing House's ownership could be monitored, the process to be followed if a gross position was held by a Clearing House Party, or how the holding of a gross position could be established as accidental or intentional with regard to the criteria. The majority of the Group therefore agreed that, aside from proof of recognised or regulated status under the FSMA for Options 1 and 2, all of the five different criteria options would be reliant upon self-certification by the Party concerned.

The Group requested that all five potential options be included in the Assessment Consultation for industry comment. The views of the consultation respondents can be found in Section 6.

### **SSMG's View Regarding Options 4 and 5**

The SSMG considered early in the Assessment Procedure that Options 4 and 5 would not be desirable, since the broad requirements of the FSA were not industry-specific. The Group agreed that organisations wishing to register as Clearing Houses under P146 should be required to comply with other BSC-specific criteria in order to ensure their appropriateness to carry out the new role under the Code. Specifically, the Group agreed that these criteria should seek to prevent BSC Parties acting as both a Clearing House and another kind of physical or non-physical trader. The SSMG agreed that this requirement would help prevent other Trading Parties or their subsidiaries registering as Clearing Houses in order to receive the benefits of P146.

### **SSMG's View Regarding Option 3**

The SSMG noted that, although the FSA's actions in respect of breaches of the FSMA could include penalties and de-recognition, neither Ofgem nor BSCCo would have jurisdiction to require the FSA to take such action. BSCCo's vires would be limited to its current actions over breaches of the Code (as provided for in Section H), by which it could ultimately prevent a Clearing House from trading through expulsion from the Code. A minority of the SSMG therefore suggested that it would be more appropriate to define Clearing Houses purely within the Code under Option 3. These members suggested that this option could be progressed under the Proposed Modification since Parties undertaking clearing activities would continue to be regulated by the FSA outside of the Code. However, the majority of the Group agreed that FSA regulation represented a key argument within the Proposal for granting benefits to Clearing Houses under the Code. These members agreed that Option 3, by not requiring the benefits of P146 to be partly conditional on such regulation, would represent an Alternative Modification.

These members also considered that Option 3 could create the risk of a large number of existing organisations meeting the requirement to be an authorised firm, with BSCCo being reliant on their self-certification if such organisations applied to be Clearing Houses under P146. The majority of the SSMG therefore agreed that Option 3 should not be progressed as part of any Alternative Modification, since this would remove the degree of reassurance provided by FSA recognition or regulation regarding

Parties' fitness to carry out clearing activities. These members considered that this was highly inadvisable given the benefits P146 would grant to the new category of Clearing House.

### **SSMG's View Regarding Options 1 and 2**

The SSMG noted that Options 1 and 2 might set a precedent by including external legislation and regulation as Code qualification criteria. Currently, where the Code requires types of pre-registration status, these take the form of licences granted by Ofgem. Under Options 1 and 2, however, the form of pre-qualification would be a recognised or regulated status outside the vires of Ofgem and the Code. Whilst the Group noted that Section V 2.5 of the Network Code references the FSMA as part of its 'Restricted User' provisions for RCHs and RIEs, it considered that the intent of these provisions is different to that of P146 since Restricted User status confers exemptions from aspects of physical trading that are not relevant for these bodies.<sup>9</sup> In return for exemption from such obligations, Restricted Users waive all rights other than the right to make nominations – and this therefore contrasts with P146, where Clearing Houses would not only continue to hold the rights and obligations of Trading Parties (subject to their registration criteria) but would also receive additional benefits.

The SSMG also considered that including references to the FSMA contained a risk of the relevant legislation, definitions and requirements changing at a future point, at which they could become inappropriate for the role of Clearing Houses under the Code. However, the Group agreed that this risk could be managed by the raising of a future Modification Proposal to amend or remove the participation category of Clearing House. The Group agreed that, even if such a situation occurred, Options 1 and 2 would ensure that those Parties registered as Clearing Houses under the Code would still be required to comply with their additional BSC-specific criteria.

During the consultation period for P146, APX announced its acquisition of UKPX/OM London and its intention to complete this process by mid-2004.<sup>10</sup> The SSMG noted that, after the completion of the acquisition, APX will continue to act as an arranger to clear its short-term contracts and will therefore not acquire OM London's status as a Recognised Investment Exchange. The Group also noted that, after this point, the only remaining BSC Party which is also a recognised body under the FSMA would be The London Clearing House (LCH, a RCH) – which does not currently provide a central counterparty clearing and notifying service in the electricity market. However, the Group noted APX's intention to clear its long-term contracts through LCH following the acquisition of UKPX, and that this may result in LCH establishing a electricity clearing service. The SSMG also noted that other organisations wishing to register as Clearing Houses under Option 1 could apply to be a RCH or a RIE and that there are currently around 17 other companies recognised as RCHs and RIEs who do not participate in the electricity market.

Following discussion of the consultation responses (see Section 6), the majority view of the SSMG was that Option 1 (restricting P146 to RCHs/RIEs only) should be progressed as the Proposed Modification. A minority of members supported the inclusion of authorised firms under Option 2.

The points below provide a summary of the respective arguments of those SSMG members in favour of Option 1 and those supporting Option 2.

#### **Majority View of SSMG – Option 1: RCH/RIE plus Code criteria**

- Some members argued that the FSA's recognition requirements for RCHs and RIEs provide an existing means of reassurance regarding such organisations' fitness for purpose, capital adequacy, market neutrality and commercial confidentiality – and that the less stringent rules for authorised firms should therefore not be included. These members argued that Option 1 would be similar to the admittance criteria for 'Restricted Users' under the Network Code, which

<sup>9</sup> The sections of the Network Code from which Restricted Users are exempt are Section L 'Maintenance and Operational Planning', Section O 'System Planning' and Section Q 'Emergencies'.

<sup>10</sup> See [http://www.eurapx.com/Pressinfo/Z\\_000745.htm](http://www.eurapx.com/Pressinfo/Z_000745.htm).

were referenced in the Proposal and which require such organisations to be either a RCH or a RIE providing its own clearing arrangements. In addition, these members considered that the recognition status of RCHs and RIEs represented the closest interpretation of the Proposal's original requirement for Clearing Houses to be 'licensed and regulated to act as a Clearing House by the appropriate regulatory body' – especially since the Group had been unable to identify any existing FSA definition of 'clearing' or 'Clearing House'.

- Other members argued that, whilst it might be preferable in theory to include all organisations undertaking clearing activities in the electricity market, the issues and concerns surrounding the Credit Default provisions of the Proposed Modification (see below) and the risks associated with self-certification meant that the Proposed Modification should be restricted to RCHs and RIEs – since this would offer greater protection to Parties that information regarding their breach of Credit Cover Percentage would remain confidential, and that Clearing Houses under P146 would not seek to profit from such information. These members noted that the FSMA, whilst placing confidentiality undertakings upon RCHs and RIEs with regard to their members' information, does not impose such requirements upon authorised firms. Although it was considered that confidentiality of Credit Default information under the Proposed Modification could be ensured via a Code obligation, the Group could not agree a process by which this could be enforced.
- Those members of the SSMG in favour of Option 1 noted that this option would exclude the Proposer after the completion of UKPX's acquisition by APX (and resulting loss of RIE status) in mid-2004. These members therefore recognised that implementation of this option would mean that no BSC Parties currently providing an electricity clearing and notifying service would benefit from the Proposed Modification after mid-2004, but that one current BSC Party (LCH) and other non-Party recognised bodies would have the potential to benefit should they decide to undertake such a service.

#### **Minority View of SSMG – Option 2: recognised body/authorised firm plus Code criteria**

- Other members of the SSMG argued that Option 1 would be discriminatory towards companies such as APX, who provide a clearing service but are not a RCH or RIE, whilst Option 2 could include all organisations undertaking clearing activities within the electricity market. These members referenced the takeover of UKPX by APX in support of this argument, since the new combined organisation will provide clearing activities as an authorised firm.
- These members included the Proposer, who argued that it had been the intention of the Modification Proposal to include all organisations offering a clearing service.

Option 1 was therefore adopted as the entry criteria for the Proposed Modification on the majority decision of the SSMG.

#### **1.3.5 SSMG's Clarification regarding Timing of Potential Credit Default Notifications**

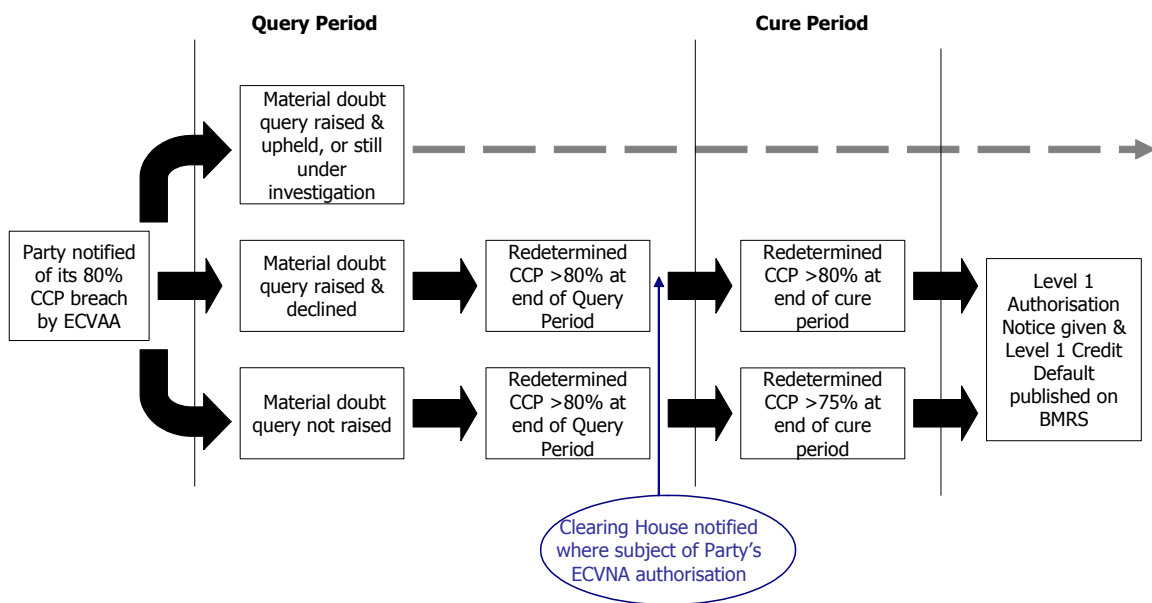
The SSMG asked the Proposer to clarify the timings of the proposed notification from the ECVA to Clearing Houses regarding their members' breach of Credit Cover Percentage. The Proposer clarified that notification should be provided to the Clearing House by e-mail at the end of the Query Period, providing that the Party's redetermined Credit Cover Percentage remained in breach (i.e. above 80%) at that time. The Proposer also clarified that the intention of P146 was for a Clearing House to receive notice of such breaches for all Parties for whom the Clearing House was authorised to submit ECVNs, regardless of whether ECVNs had actually been submitted at the time of the breach.

The Group noted that a Party whose Credit Cover Percentage was greater than 80% but less than 90% at the end of the Query Period would not at that stage have entered Level 1 Credit Default, since a Level 1 authorisation notice would not be published until the end of the following default cure period.

The Proposer confirmed that the intention of P146 was for Clearing Houses to receive notice of the potential Credit Defaults of their members before confirmation of the Default is made available to all Parties via the Balancing Mechanism Reporting Service (BMRS). Where a member resolved its potential Default during the Query Period, the Clearing House would not be informed. However, where a member resolved its potential Default during a Level 1 default cure period, Clearing Houses would receive information not made available to other Parties.

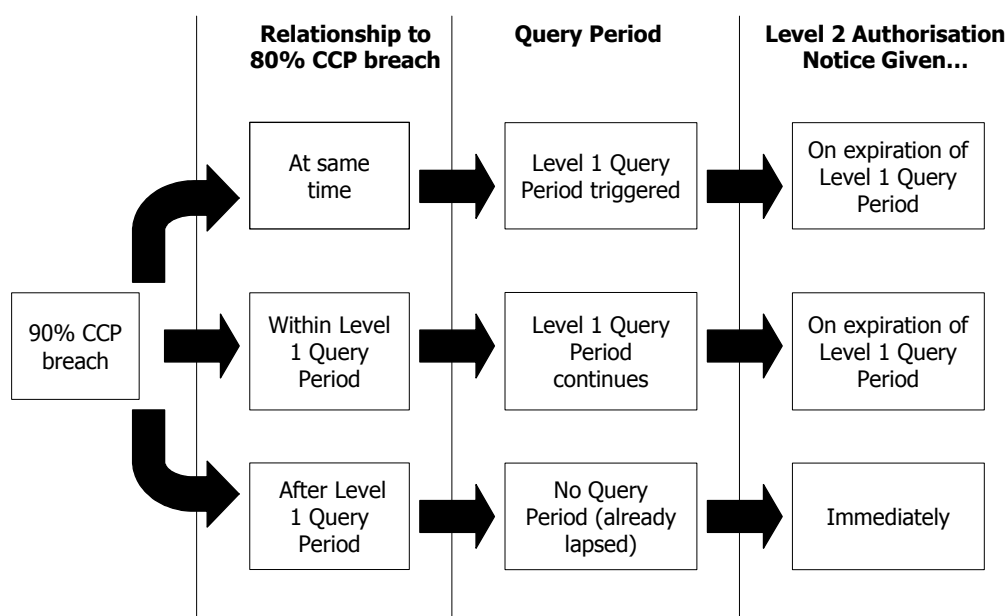
Figure 5 shows the relationship between the proposed notification to Clearing Houses and the existing Level 1 Credit Default process.

**Figure 5 – Timetable of Level 1 Credit Default Provisions**



The SSMG noted that a Party whose Credit Cover Percentage was greater than 90% at the end of the Query Period would be subject to a Level 2 Credit Default authorisation notice and would therefore enter Level 2 Credit Default since there is currently no Level 2 cure period. The Group also noted that the length or occurrence of a Query Period in the event of a 90% breach would depend upon whether a Level 1 Query Period had already begun, had ended, or had not begun.

Figure 6 on the following page outlines the Level 2 process in more detail.

**Figure 6 – Timetable of Level 2 Credit Default Provisions**

The SSMG noted that Clearing Houses would therefore not receive earlier notification of Level 2 Credit Defaults where a Party breached 80% and 90% of its Credit Cover Percentage simultaneously, or where a Party breached 90% during a Level 1 Query Period, since notice of the Level 2 Default would be published on the BMRS at the end of the Query Period. However, where a Party breached 90% following a Level 1 Query Period the Clearing House would have received notification of its 80% breach at the end of the Query Period, and would therefore have had the opportunity to contact the Party concerned to ascertain the situation (since the level of the breach would not be provided to the Clearing House by the ECVA).

### 1.3.6 SSMG's Clarification of Interaction with Modification Proposal P142

The SSMG also noted that, if approved, Modification P142 'Minor Refinement to Allow a Level 2 Default Cure Period in Defined Circumstances' ('P142') would introduce a default cure period for Level 2 Credit Defaults where a Party's Credit Cover Percentage exceeded 90%, but remained below 100%, outside normal business hours. The Level 2 default cure period proposed by P142 would last for two hours into the next Business Day. If both P142 and P146 were implemented, Clearing Houses would therefore receive early notification at the end of the Query Period for potential Level 2 Credit Defaults where a member breached 90% outside of business hours. However, the Group noted that the solutions to P142 and P146 are independent of each other.

### 1.3.7 SSMG's Inclusion of Conditions Regarding Material Doubt

The SSMG considered that Clearing Houses should only receive notifications of members' breaches of Credit Cover where there was no potential for material doubt. The Group agreed that such notifications might lead a Clearing House to trade away from a Party, or place it in default under its own membership rules, and should therefore only be issued where there was no question of error in determining the Party's Credit Cover Percentage. Since the ECVA does not hold information relating to the outcome of material doubt investigations, the Group noted that the addition of this provision would require the ECVA to check the existence of material doubt with BSCCo at the end of the Query Period. The SSMG agreed that this checking process should be included within the proposed solution as an addition to the current process whereby the ECVA contacts BSCCo with the Party's redetermined Credit Cover Percentage. The SSMG noted the incremental BSC Agent costs resulting from this

inclusion (an increase of £6,541 to the change-specific cost for the Proposed Modification), and that BSCCo would have responsibility for instructing the ECVAAs to send or withhold notification to the Clearing House.

### **1.3.8 SSMG's Clarification of Credit Information to be Provided to Clearing Houses**

The SSMG agreed that the notification from the ECVAAs to the Clearing House would contain the following information:

- The name of the Party in breach for which the Clearing House held an ECVNA Authorisation; and
- Notification that the Party concerned was still in breach of its Credit Cover Percentage at the end of a Query Period.

The SSMG agreed that the exact percentage of the Party's breach (or whether it represented a Level 1 or Level 2 breach) would not be notified, and that such commercial information should remain confidential to BSCCo, the ECVAAs and the Party concerned. The Group considered that any obligation for members to provide exact details regarding their Credit Cover Percentage would not be appropriate under the Code, but could be pursued by Clearing Houses outside of the Code through their own contracts if desired.

### **1.3.9 SSMG's Development of Semi-Manual Solution for Credit Default Notifications**

The SSMG agreed that the costs of the fully-automated solution proposed by the BSC Agent (approximately £66,446 change-specific cost) for the CRA and ECVAAs systems to match defaulting Parties with Clearing House authorisations and generate an e-mail notification would outweigh any potential benefit to competition from the Proposed Modification.

However, the SSMG noted the BSC Agent's advice that a fully manual solution to the Credit Default aspect of P146 would be too complex to implement, and that some degree of ECVAAs system changes to introduce search scripts and e-mail notification templates would therefore be necessary. The Group recognised that changes would also be required to CRA systems to reflect the new market role of Clearing House, in order that the ECVAAs could identify any ECVNA Authorisations relating to Clearing Houses. The Group therefore agreed that this semi-manual solution should be progressed.

The SSMG also noted the concerns of the BSC Agent that the semi-manual solution would require a complex process, potentially involving out-of-hours helpdesk staff, and therefore contained a risk of non-notification or mis-notification. However, the Group considered that this solution should be progressed since it represented the most cost-effective option (approximately £26,758 change-specific cost).

A copy of the BSC Agent's impact assessment is attached as Annex 4.

### **1.3.10 SSMG's Development of New Manual Charging Mechanism for Clearing Houses**

The SSMG noted that the Proposal seeks to invoice Clearing Houses for Notified Volume Charges relating to positive energy volumes only, and that the ECVAAs currently provides BSCCo with total volumes per Energy Account via the ECVAAs-I023 'ECVAAs BSC Section D Charging Data' report. The Group therefore considered a possible solution whereby the ECVAAs would separately identify the positive energy volumes for Clearing Houses, in order for BSCCo to only invoice such Parties for positive volumes. However, the Group considered that the costs of this semi-automated solution (approximately £51,288 change-specific cost - see Annex 4) would outweigh the benefits of P146, and therefore agreed a manual solution under which BSCCo would halve the Notified Volume Charges invoiced to Clearing Houses. The SSMG agreed that, as the central counterparty role of Clearing Houses means that such organisations always seek to hold a net position of zero, this solution would be similar in accuracy to one which charged only for positive volumes. Moreover, the Group agreed that

the halved-charges solution would represent a more cost-effective approach, since it could be implemented by BSCCo without a Central Systems change.

The SSMG recognised that neither charging Clearing Houses for positive volumes only nor halving Notified Volume Charges for such Parties would take account of any instances where the Clearing House did not manage deliver both halves of a cleared trade and was left in imbalance. The Group noted that a more accurate charging structure might be to sum positive and negative volumes separately, and charge a Clearing House for the largest set of volumes when it was in imbalance. However, the SSMG agreed not to progress this mechanism as a potential Alternative Modification due to the level of impact it would require upon Central Systems. The Group noted that Clearing Houses would continue to be subject to imbalance charges if they failed to deliver both halves of a trade, and that their entry criteria under P146 would require them to seek to hold a net position of zero at all times.

### **1.3.11 SSMG's Discussion of Materiality of Halved Notification Charges for Clearing Houses under Proposed Modification**

The SSMG noted that BSCCo's charges to Parties are used to recoup the cost of its operations, and that for any shortfall figure resulting from reduced Notified Volume Charges for Clearing Houses an equal figure would be recouped through Trading Parties' Main Funding Shares. BSCCo's Business Strategy and Annual Budget for 2004-2007 has estimated that it will recover £3.9 million (5.9% of BSC costs) annually via Notified Volume Charges. The SSMG also noted that the current Notified Volume Charge of £0.0025/MWh was intended at NETA Go-Live to be broadly reflective of the cost incurred by the ECVA in processing each ECVN, and that Annex D-3 provides the Panel with existing authority to change this figure for all Parties if it determined the current level not to be cost-reflective.

The SSMG, with the consent of the Proposer, therefore requested that BSCCo investigate the materiality of halved Notified Volume Charges for OM London Exchange. Using the average monthly Notified Volume Charge invoiced to OM London during April-November 2003, BSCCo calculated an annualised cost-saving of £18,000 if these charges had been halved by P146.

The SSMG considered the implications of APX's acquisition of UKPX upon this analysis. The Group noted that combining the annualised savings for APX and OM London gave an overall saving of £19,000 for the merged organisation. However, the SSMG recognised that the Group's decision to restrict the Proposed Modification to RCHs and RIEs under Option 1 would mean that APX (as an authorised firm) would not benefit from its implementation whilst OM London would only benefit until the completion of its acquisition and resulting loss of RIE status.

The SSMG noted APX's intention to clear its long-term contracts through The London Clearing House – and that part of the above cost-saving figure would therefore be passed to LCH. However, the Group noted that no historic Notified Volume Charge figures are available for LCH (since they do not currently provide an electricity central counterparty clearing and notifying service) and that LCH had declined to respond to the Assessment Consultation.

The SSMG therefore agreed that it was not possible to fully explore the materiality of halved Notified Volume Charges for Clearing Houses under the Proposed Modification.

## **1.4 Assessment of whether the Proposed Modification would better facilitate the Applicable BSC Objectives**

This section represents a summary of the SSMG's assessment of the Proposed Modification against the Applicable BSC Objectives. The SSMG, in undertaking this assessment, took account of the views expressed by respondents to the Assessment Consultation (see Section 6).

### Majority View Against Proposed Modification

The majority of the SSMG (with the exception of the Proposer) concluded that the Proposed Modification P146 would not better facilitate the Applicable BSC Objectives, since its provisions for Clearing Houses to receive warning of members' potential Credit Defaults would have a negative impact on Applicable 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'.

The following arguments were expressed in support of this view:

- That Code provisions to mitigate the risk to Clearing Houses of their counterparties' potential Credit Defaults would provide such organisations with a commercial advantage, since all Parties are exposed to such risks;
- That providing Clearing Houses with notification of potential Credit Defaults would also be inconsistent with the rationale behind the default cure period, which is intended to provide Parties with a last opportunity to resolve their breach of Credit Cover before entering Credit Default (and thereby triggering the associated consequences);
- That providing information regarding a Party's breach of Credit Cover to any organisation other than the ECVAAs and BSCCo could adversely impact that Party's reputation, and that an important part of the rationale for the cure period is also to allow Parties a last chance to avoid public identification as being in Credit Default (shown by Parties' support for P142);
- That the FSMA requires RCHs and RIEs to share information regarding their own defaults with other recognised bodies and the FSA, and that such sharing of information regarding a Party's potential Credit Default could have a further negative impact on its reputation;
- That a Clearing House's priority would be to its own operations, and that the Proposed Modification might worsen a Party's potential Credit Default if the Clearing House chose to trade away from that Party or place the Party in default under its own rulebook;
- That any action of the Clearing House which worsened the position of the Party in breach could also negatively impact the positions of the Party's other counterparties – and that the benefit of the Proposed Modification to Clearing Houses would therefore be achieved at the expense of other BSC Parties, who would not be privy to such information;
- Conversely, that a Clearing House would gain a commercial advantage where it offered the Party an opportunity to trade out of its potential Credit Default with the Clearing House;
- That, since the Party would have been notified by the ECVAAs and contacted by BSCCo when it breached its Credit Cover Percentage, there would be little additional benefit in a Clearing House being able to discuss the situation with the Party at the end of the Query Period – and that this could create the potential for the Clearing House to advise the Party the Clearing House's own interest;
- That, since the provisions contained no time-limit on ECVNA Authorisations, the Clearing House could receive notification of potential Credit Defaults by Parties with whom the Clearing House was not trading (or intending to trade) at the time of the breach; and
- That the number of occasions where Clearing Houses would receive notifications of members' potential Credit Defaults would be too few to justify the cost to industry of implementing the Proposed Modification.

In summary, the majority view of the SSMG was that it would not be appropriate to introduce a Code obligation for the ECVAAs to provide Clearing Houses with Credit Default information – since this would



create a conflict of interest between the Clearing House and the Code – and that this was therefore a matter to be pursued by the Clearing House outside the Code through its own contracts with members. These members considered that although Parties might not have out-of-hours resources, they would have the full 24-hour Query Period in which to notify the Clearing House of their breach if required to do so by their contract with the Clearing House.

### **Minority View in Support of Proposed Modification**

In contrast, the minority view of the Proposer was that the Credit Default provisions of the Proposed Modification P146 would better facilitate competition and Applicable Objective (c). In addition to the rationale expressed in the Modification Proposal, the Proposer put forward the following arguments in support of this view:

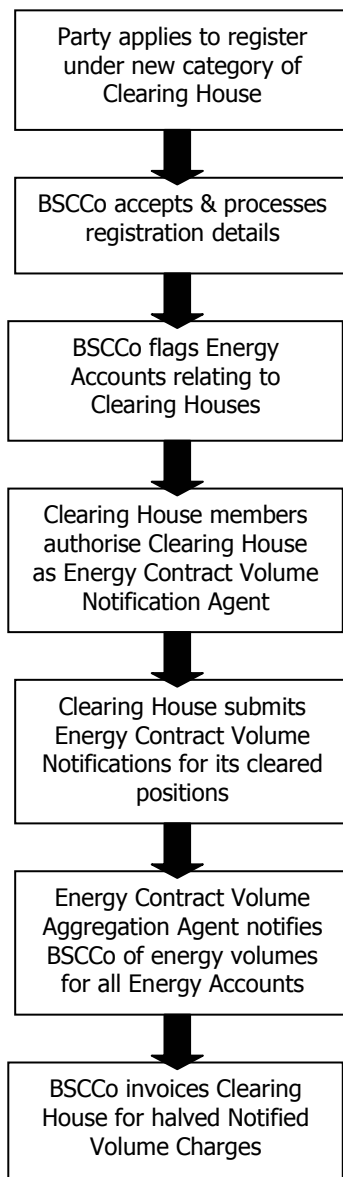
- That the margin lodged by a member with a Clearing House is not necessarily sufficient to cover the risk of the Clearing House being exposed to imbalance charges in the event of that member's Credit Default, and that Credit Defaults therefore represent a real risk to the sustainability of a Clearing House's operations;
- That although Parties in breach of their Credit Cover Percentage are informally advised by BSCCo to notify their counterparties if there is a risk to their trades, this is not a formal (or enforceable) Code obligation;
- That imposing such an obligation on members through a Clearing House's own contracts might not be sufficient, since breaches could occur outside working hours and the Party concerned might not be resourced to provide prompt notification to the Clearing House;
- That the Proposed Modification would provide Clearing Houses with an opportunity to contact the Party in breach in order to help resolve its potential Credit Default;
- That the Proposed Modification would therefore enable Clearing Houses to offer a market route by which members could resolve their potential Credit Defaults, and could thereby facilitate competition; and
- That Clearing Houses would only seek to trade away from a Party as a last resort.

The SSMG also noted BSCCo's advice that the primary function of the current Code participation capacities is to reflect the different activities that each kind of Party carries out under the Code, in order that the necessary registration requirements and system qualifications can be appropriately identified. Rights, obligations, accruals and liabilities then flow from the items each Party has to register (e.g. Energy Accounts, BM Units) in order to carry out its activities under the Code. If the distinctiveness of Clearing Houses results from activities or a status outside the Code, P146 might therefore set a precedent of rights and obligations resulting directly from a Code capacity. However, the SSMG considered that the introduction of a new 'Clearing House' subset of Trading Party was neutral with regard to the Applicable BSC Objectives.

The view of the SSMG was split regarding the merits of halving Notified Volume Charges for Clearing Houses. However, the majority of the Group supported the development of an Alternative which removed the Credit Default provisions of the Proposed Modification and therefore consisted of the new participation category and charging aspects of P146. The SSMG's discussions regarding the merits of this Alternative are outlined in Sections 1.5-1.7 below.

## **1.5 Alternative Modification**

Figure 7 provides a high-level overview of the solution developed by the SSMG to support the Alternative Modification.

**Figure 7 – Overview of Alternative Modification**

Summaries of the new processes which would result from the implementation of this solution are given below.

### 1.5.1 New Category of 'Clearing House' – Manual Solution

- The new Code category of Clearing House would be created as a sub-category of the current Trading Party participation capacity.
- Within this sub-category, Clearing House Parties would continue to hold the same rights and obligations as Trading Parties, subject to the following criteria:
  - The registering Party be either a recognised body or an authorised firm under the FSMA;
  - The Party must provide a central counterparty clearing service as part of its business activities;

- The Party shall not seek to trade or hold gross positions in electricity contracts, but shall seek to hold a net position of zero at all times;
  - The Party may not hold BM Units; and
  - The Party must operate independently from any Party trading or holding gross positions under the Code, or which holds BM Units.
- Organisations wishing to register within this new category would be required to undertake a self-certification Market Entry process, by providing BSCCo with evidence of their status as a recognised body or authorised firm and by completing a signed undertaking to meet the above entry criteria.
  - Each Clearing House Party would be obliged to notify BSCCo if, at any time, it became aware of any reason why it could no longer comply with the entry criteria for Clearing Houses. No formal monitoring to enforce Clearing Houses' compliance with the criteria would be undertaken by BSCCo.

### **1.5.2 Single Notified Volume Charge for Clearing Houses – Manual Solution**

BSCCo would halve the Notified Volume Charges to be invoiced to each Party registered as a Clearing House under the Code.

## **1.6 Issues Raised by the Alternative Modification**

### **1.6.1 SSMG's Consideration of Appropriate Code Entry Criteria for Clearing Houses under Alternative Modification**

One member of the SSMG argued that the same entry criteria should be adopted for the Proposed and Alternative Modifications, since the financial benefits to Clearing Houses of both would be the same. However, another member of the Group considered that the Proposed Modification would grant an extra benefit of privileged knowledge of Parties' breaches of Credit Cover in addition to the financial savings resulting from halved Notified Volume Charges. This member therefore considered that, since the Alternative removed such Credit Default provisions, the entry criteria for the Alternative could be wider than for the Proposed Modification. The majority of the SSMG agreed with this view, and concluded that Option 2 (restricted to recognised bodies and authorised firms, plus Code criteria) should be adopted for the Alternative. One member disagreed and believed that Option 1 (restricted to RCHs/RIEs only, plus Code criteria) should be used for the Alternative as well as the Proposed Modification – since widening the FSA-regulation criteria to include authorised firms contained an increased risk that the self-certification entry process could be abused in order to achieve the benefits of halved charges. However, the majority of the SSMG considered that this risk would not be material and that only a few Parties were realistically likely to apply to be Clearing Houses.

The SSMG therefore agreed to progress Option 2 as the entry criteria for Clearing Houses under the Alternative Modification. The Group noted the advice received from BSCCo's external legal advisors that there would be potential difficulties in the legal effect of an obligation on a Clearing House to take all reasonable measures to ensure that the Account Energy Imbalance Volume is zero. The Group noted that the draft legal text therefore included the alternative provisions that Energy Contract Volume Data or Metered Volume Reallocation Data shall not be notified on behalf of a Clearing House other than in relation to the clearing arrangements operated by the Clearing House, and that Clearing Houses shall not be responsible for any Imports or Exports. The SSMG agreed this change, and recognised that this would help prevent such organisations receiving the benefits of P146 for 'normal' ECVNA-notified trades in addition to cleared trades (see 1.3.3). The Group noted that Clearing House Parties

under P146 would continue to be able to act as an ECVNA providing they did not use their Energy Accounts as part of this service.

### **1.6.2 SSMG's Discussion of Materiality of Halved Notification Charges for Clearing Houses under Alternative Modification**

The SSMG therefore recognised that APX and OM London/UKPX (and the combined organisation resulting from APX's completed acquisition of UKPX by mid-2004) would currently be able to register as Clearing House Parties under the Alternative Modification, and noted BSCCo's calculation of a combined saving of £19,000 per annum for these two Parties based on their payments of Notified Volume Charges between April-November 2003. However, the Group also noted that part of this cost-saving would be transferred to The London Clearing House if APX followed its intention to clear its long-term contracts through LCH following its acquisition of UKPX (and if LCH applied for Clearing House status under the Code).

### **1.6.3 SSMG's Consideration of Legal Advice Regarding Alternative Modification**

The SSMG noted the advice of BSCCo's Legal Department that an Alternative Modification comprising the new 'Clearing House' participation category and halved Notified Volume Charges (i.e. with the Credit Default warning provisions removed) might not constitute a valid Alternative Modification Proposal. The Group recognised that paragraph F 2.6 of the Code states that assessment of any Alternative Modification Proposal should be concerned with whether the Alternative 'would, as compared with the Proposed Modification, better facilitate achievement of the Applicable BSC Objective(s) in relation to the issue or defect identified in the Modification Proposal'. The SSMG also noted that BSCCo's legal interpretation of the defect identified by P146 is that the Code fails to recognise the role of Clearing Houses *in two ways*: firstly, in the inability of the ECVAA to provide Clearing Houses with notification of their members' potential Credit Defaults and, secondly, in its failure to apply a different charging schedule to Clearing Houses. This legal advice therefore considered that the Credit Default and charging aspects of the Modification Proposal represent an integral part of the defect, rather than mere detail – and pointed to the Proposal's statements that '[the Code's] inability to facilitate the operation of clearing organisations *is manifest in* the inability of the ECVAA to supply information to the Clearing House in the event of one of the Clearing House's counterparties going into Credit Default', and that '*[a]nother area in which* the BSC's failure to recognise the role of Clearing Houses is in the charging schedule applied to the submission of Energy Contract Notifications'.

Given this advice, a minority of the SSMG did not support the progression of the Alternative Modification. However, the majority of the Group argued that what constituted the defect or the detail within the Proposal was a matter of interpretation. These members of the SSMG interpreted the defect identified by P146 to be that the Code does not recognise the role of Clearing Houses – and that the Credit Default and charging aspects of the Proposal were *examples* of how this defect is manifested. These members therefore concluded that an Alternative comprising only one of these aspects could still address the defect, and could be argued to better facilitate achievement of the Applicable BSC Objectives where the other aspect was not felt to facilitate any Objectives. This interpretation was supported by the Proposer. The majority of the SSMG therefore agreed that the proposed Alternative Modification for P146 represented a valid Alternative Proposal in accordance with F 2.6, and that progression of this Alternative would be a pragmatic approach. Although some of these members had sympathy with the legal view, they considered that too restrictive an interpretation of defects in Modification Proposals would either lead to future Modifications Proposals being very loosely defined (and therefore requiring greater use of the Definition Procedure) or to the raising of separate Modification Proposals in place of Alternatives to de-scope existing Proposals – and that the increased costs of either of these approaches would run against the Panel's obligation to operate the Modification

Procedures in an 'efficient, economical and expeditious manner' in accordance with paragraph F 1.2.2(a) of the Code. Moreover, these members noted that the Panel had explicitly actioned the SSMG to consider such a de-scoped Alternative as part of its Terms of Reference (see Annex 2).

The majority of the SSMG therefore agreed to progress the Alternative Modification, and to present its own interpretation of the defect identified by P146 to the Panel, along with the legal view, to be considered when making its recommendation to the Authority.

## **1.7 Assessment of whether the Alternative Modification would better facilitate the Applicable BSC Objectives**

This section represents a summary of the SSMG's assessment of the Alternative Modification against the Applicable BSC Objectives. The SSMG, in undertaking this assessment, took account of the views expressed by respondents to the Assessment Consultation (see Section 6).

### **Majority View in Support of Alternative Modification**

The majority of the SSMG concluded that the Alternative Modification P146 would, as compared with the current Code arrangements and against the Proposed Modification, better facilitate achievement of the Applicable BSC Objectives in relation to the defect identified by the Modification Proposal. These members agreed that the Alternative Modification would better facilitate Applicable Objective (c), and expressed the following arguments in support of this view:

- That Clearing Houses facilitate competition, and that the current application of Notified Volume Charges represents a cross-subsidy which discriminates against Clearing Houses and acts as a barrier to their operations;
- That halving Notified Volume Charges for Clearing Houses would therefore correct this discrimination and provide a 'level playing field' between Clearing Houses and other Trading Parties;
- That the incremental cost of processing Clearing Houses' 'extra' ECVNs is not material, and that if charges were halved for Clearing Houses BSCCo would continue to receive three out of four of the Notified Volume Charges currently incurred by a cleared trade (see Figure 3);
- That even if P146 resulted in an increased number of Clearing Houses, or increased trade for existing Clearing Houses, BSCCo would not 'lose' any Notified Volume Charges resulting from Parties' switching from bilateral to cleared trades but would in effect gain an 'extra' charge since the Clearing House and both its counterparties would continue to pay one charge each (see Figures 2 and 3);
- That there is potential for the cost-saving to Clearing Houses resulting from halved Notified Volume Charges to be passed on to their members, and that this would facilitate use of Clearing Houses and thereby competition through a mutually-beneficial arrangement between the interests of the Code and of Clearing Houses; and
- That the fact that the fees charged to Clearing House members lie outside the Code could not be used as an argument *against* P146.

### **Minority View Against Alternative Modification**

A minority of the SSMG considered that the Alternative Modification P146, as compared with the Proposed Modification and against the current Code arrangements, would not better facilitate achievement of the Applicable BSC Objectives in relation to the defect identified by the Modification Proposal. These members argued that the Alternative Modification would have a negative impact on Applicable Objective (c), and put forward the following arguments in support of this view:

- That Clearing Houses make a commercial decision to act as a central counterparty to trades and, moreover, that they are not currently discriminated against since they recover their costs through their own charges to members;
- That any cost-savings for Clearing Houses from halved Notified Volume Charges would be recovered via Parties' Main Funding Shares, and that this would effectively create a cross-subsidy for Clearing Houses (who, since they are not physical traders, do not pay Main Funding Shares);
- That the current arrangements – whereby those Parties wishing to gain the benefit of using a Clearing House cover the cost resulting from the additional notified volume – is more appropriate than P146's proposal to recover the additional volume cost from all Parties;
- That if a large number of Parties registered as Clearing Houses under the Code, P146 could require a greater figure to be recovered via Parties' Main Funding Shares (since the ratio of Notified Volume Charges to ECVNs would decrease);
- That the cost of a Clearing House ECVN is no different to that of an ECVN submitted by any other Party, and that both the Proposed and Alternative Modifications would therefore create a conflict between the intention of the Code's charging schedule and the commercial interests of Clearing Houses;
- Moreover, that if P146 incentivised Parties to switch from bilateral to cleared trades, the level of received Notified Volume Charges might no longer cover the ECVAA's costs in processing ECVNs (since although 2 extra ECVNs could be submitted for the cleared trade, only 1 extra Notified Volume Charge would be incurred);
- That the Modification Proposal makes no reference to passing on any cost-savings to Clearing House members, and that this could therefore not be used as an argument in favour of P146 since the fees charged to Clearing House members lie outside the Code; and
- In summary, that the benefit to Clearing Houses of both the Proposed and Alternative Modifications would be achieved at the expense of other BSC Parties.

## 1.8 Governance and Regulatory Framework Assessment

The SSMG noted that P146 may introduce a regulatory precedent by referencing financial legislation as a Code qualification criteria (see Sections 1.3 and 1.6).

## 2 COSTS

### 2.1 Costs of Progressing P146 through the Modification Procedures

#### PROGRESSING MODIFICATION PROPOSAL

<b>Demand Led Cost</b>	£0
<b>ELEXON Resource</b>	60 man days (equating to approximately £11,700)

## 2.2 Implementation Costs - Proposed Modification

### IMPLEMENTATION COSTS – Proposed Modification P146

		Stand Alone Cost	P146 (Proposed) Incremental Cost	Tolerance
<b>Service Provider<sup>11</sup> Cost</b>	Change Specific Cost	£26,758	£26,758	+/-0%
	Release Cost	£257,021		+/-0%
	Incremental Release Cost	£3,540	£3,540	+/-0%
	<b>Total Service Provider Cost</b>	<b>£287,319</b>	<b>£30,298</b>	<b>+/-0%</b>
<b>Implementation Cost</b>	External Audit	£23,000	£2,500	+/-25%
	Design Clarifications	£14,000	£1,500	+/-100%
	Additional Resource Costs	£0	£0	N/A
	Additional Testing and Audit Support Costs	£40,000		+/-25%
<b>Total Demand Led Implementation Cost</b>		<b>£364,319</b>	<b>£34,298</b>	<b>+/-8%</b>

<b>ELEXON Implementation Resource Cost</b>		393 man days £157,200	203 man days £81,200	+/-5%
<b>Total Implementation Cost</b>		<b>£521,519</b>	<b>£115,498</b>	<b>+/-7%</b>

<sup>11</sup> BSC Agent and non-BSC Agent service provider and software costs.

## ONGOING SUPPORT AND MAINTENANCE COSTS – Proposed Modification P146

	Stand Alone Cost	P146 (Proposed) Incremental Cost	Tolerance
Service Provider Operation Cost	£0 per annum	£0 per annum	N/A
Service Provider Maintenance Cost	£2,680 per annum	£2,680 per annum	+/-0%
ELEXON Operational Cost	£1,200 per annum	£1,200 per annum	+/-25%

### 2.3 Implementation Costs - Alternative Modification

## IMPLEMENTATION COSTS – Alternative Modification P146

		Stand Alone Cost	P146 (Alternative) Incremental Cost	Tolerance
<b>Service Provider<sup>12</sup> Cost</b>	Change Specific Cost	N/A	N/A	N/A
	Release Cost	N/A	N/A	N/A
	Incremental Release Cost	N/A	N/A	N/A
	Total Service Provider Cost	N/A	N/A	N/A
<b>Implementation Cost</b>	External Audit	N/A	N/A	N/A
	Design Clarifications	N/A	N/A	N/A
	Additional Resource Costs	N/A	N/A	N/A
	Additional Testing and Audit Support Costs	N/A	N/A	N/A
<b>Total Demand Led Implementation Cost</b>		N/A	N/A	N/A

<sup>12</sup> BSC Agent and non-BSC Agent service provider and software costs.



<b>ELEXON Implementation Resource Cost</b>		142 man days £56,800	62 man days £24,800	+/-5%
<b>Total Implementation Cost</b>		£56,800	£24,800	+/-5%

### **ONGOING SUPPORT AND MAINTENANCE COSTS – Alternative Modification**

	<b>Stand Alone Cost</b>	<b>P146 (Alternative) Incremental Cost</b>	<b>Tolerance</b>
Service Provider Operation Cost	N/A	N/A	N/A
Service Provider Maintenance Cost	N/A	N/A	N/A
ELEXON Operational Cost	£2,400 per annum	£2,400 per annum	+/-25%

### **3 RATIONALE FOR MODIFICATION GROUP'S RECOMMENDATIONS TO THE PANEL**

As detailed in Section 1, the majority of the SSMG agreed:

In respect of the Proposed Modification, that:

- The Proposed Modification would not better facilitate the Applicable BSC Objectives, but would have a negative impact upon Objective (c) (promoting effective competition) since the provision of early information regarding the potential Credit Defaults of other BSC Parties would provide Clearing Houses with a commercial advantage and thereby discriminate against the rest of the market. This was considered to outweigh any benefit to Objective (c) resulting from halved Notified Volume Charges for Clearing Houses (see below).

In respect of the Alternative Modification, that:

- The proposed Alternative Modification represents a valid Alternative for consideration under F 2.6.2; and that
- The Alternative Modification would better facilitate Applicable BSC Objective (c), since the Alternative would correct a discrimination against Clearing Houses present in the current application of Notified Volume Charges and may result in corresponding cost-savings for Clearing House members.

### **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 impacted by the Proposed and/or the Alternative Modification.

## 4.1 BSCCo

The table below provides a summary of the effort required by BSCCo to support the Proposed Modification.

Area of Business	Impact of Proposed Modification	Impact of Alternative Modification
Market Entry	<p>14 man days' effort to amend the following Market Entry/Exit software and documentation:</p> <ul style="list-style-type: none"> <li>- Market Entry Database and User Guide;</li> <li>- BSCP65 (support to CVA Programme);</li> <li>- New Qualification BSCP resulting from CP502 (if implemented before or with P146);</li> <li>- Local Working Instructions relating to Accession, Registration, Qualification and Withdrawal; and</li> <li>- BSC Website pages and checklists relating to new Clearing House category (support to Web Team).</li> </ul> <p>6 man day's operation effort per annum would be required to process applications from organisations wishing to become Clearing Houses under the Proposed Modification (calculated on the assumption that 1 Party is likely to apply under the Proposed Modification – namely LCH).</p>	<p>Same as for the Proposed Modification, with the exception of 9 man day's operational effort per annum (calculated on the assumption that 2 Parties are likely to apply to be Clearing Houses under the Alternative Modification – namely LCH and APX/UKPX).</p>
Credit Default Management	<p>8 man days' effort to amend operational Local Working Instructions and Material Doubt Guideline.</p> <p>0 man days' operational effort per annum, since the new steps proposed by P146 would be subsumed within existing operational processes.</p>	None.
Charging	5 man day's effort to amend working practices in order to invoice any Clearing House Parties for halved Notified Volume Charges.	Same as for Proposed Modification.
CVA Programme	<p>341 man days' effort would be required to implement the Proposed Modification as a stand-alone change (comprising 129 man days' technical resource, 22 days' variable release costs and 190 man days' fixed release costs).</p> <p>Alternatively, 151 man days' effort would be required to implement the Proposed Modification with other system changes as part of a planned Release (comprising 129 man days' technical resource plus 22 days' variable release costs).</p>	<p>117 man days' effort would be required to implement the Alternative Modification as a stand-alone change.</p> <p>Alternatively, 37 man days' effort would be required to implement the Alternative Modification with other changes as part of a planned Release.</p>
Systems Assurance	20 man days' programme assurance.	1 man day's programme assurance.
Website	5 man days' effort to develop and add new	Same as for Proposed

Area of Business	Impact of Proposed Modification	Impact of Alternative Modification
	'Clearing House' participation category (and any new registration checklists) to Market Entry and Market Exit pages of the BSC Website.	Modification.

The total ELEXON resource cost to implement P146 is outlined in Section 2.

## 4.2 BSC Systems

### Proposed Modification

The table below provides a summary of the BSC Systems changes required to support the Proposed Modification. Information regarding the associated documentation changes can be found in Section 5, whilst the BSC Agent costs are outlined in Section 2.

System / Process	Potential Impact of Proposed Modification
Registration	The Proposed Modification would require a new Clearing House role code to be added to the CRA system. Changes would also be required to CRA documentation.
Contract Notification	The Proposed Modification would require a new search script to be developed for the ECVAA system, in order to return matches between a Party in breach of its Credit Cover Percentage and any authorisations between that Party and Clearing Houses. Changes would also be required to ECVAA documentation.
Credit Checking Systems	As above. Additional changes to the ECVAA system would be required to reflect the processes by which the ECVAA alerts BSCCo of such authorisations at the time of the breach, and by which BSCCo instructs the ECVAA whether to notify a Clearing House at the end of a Query Period. Changes would also be required to ECVAA documentation.

### Alternative Modification

No BSC Systems changes are required to support the Alternative Modification.

## 4.3 Parties and Party Agents

No impact upon Parties or Party Agents were identified during the Assessment Procedure for P146. Two 'no impact' responses were received to the Detailed Level Impact Assessment and are attached as Annex 5.

## 5 IMPACT ON CODE AND OTHER DOCUMENTATION

### 5.1 Balancing and Settlement Code

#### Proposed Modification

The Proposed Modification P146 would impact the following Code Sections:

- Section A 'Parties and Participation' – addition of new subcategory of Trading Party participation capacity and self-certification Market Entry process.

- Section D 'BSC Cost Recovery and Participation Charges', Annex D-3 'Specified BSC Charges' – amendment so that the Notified Volume Charge calculation is halved for Clearing Houses.
- Section K 'Classification and Registration of Metering Systems and BM Units' – addition of obligation that Clearing Houses shall not seek to hold gross positions.
- Section P 'Energy Contract Volumes and Metered Volume Reallocations' – addition of obligation that Clearing Houses shall not submit Energy Contract Volume Data or Metered Volume Reallocation Data in respect of their Energy Accounts except where such data relates to cleared trades.
- Section M 'Credit Cover and Credit Default' – addition of obligation for the ECVAA (where instructed by BSCCo) to notify a Clearing House that a Party for whom the Clearing House is authorised to submit ECVNs remains in breach of its Credit Cover Percentage at the end of a Query Period. Addition of related obligation for BSCCo to instruct the ECVAA to send such notification providing material doubt is not being investigated at the end of the Query Period.
- Annex X-1 'General Glossary' – addition of new definition of Clearing House as a Trading Party satisfying the relevant entry criteria.

### **Alternative Modification**

The Alternative Modification P146 would impact the following Code Sections:

- Section A 'Parties and Participation' – addition of new subcategory of Trading Party participation capacity and self-certification Market Entry process.
- Section D 'BSC Cost Recovery and Participation Charges', Annex D-3 'Specified BSC Charges' – amendment so that the Notified Volume Charge calculation is halved for Clearing Houses.
- Section K 'Classification and Registration of Metering Systems and BM Units' – addition of obligation that Clearing Houses shall not seek to hold gross positions.
- Section P 'Energy Contract Volumes and Metered Volume Reallocations' – addition of obligation that Clearing Houses shall not submit Energy Contract Volume Data or Metered Volume Reallocation Data in respect of their Energy Accounts except where such data relates to cleared trades.
- Annex X-1 'General Glossary' – addition of new definition of Clearing House as a Trading Party satisfying the relevant entry criteria.

A copy of the legal text for the Alternative Modification is provided in Annex 1. No legal text has been provided for the Proposed Modification.

## **5.2 Code Subsidiary Documents**

### **Proposed Modification**

The Proposed Modification P146 would impact the following Code Subsidiary Documents:

- BSCP65 'Registration of Parties and Exit Procedures' – addition of new Clearing House subcategory of Trading Party and associated Market Entry and Market Exit processes.
- Reporting Catalogue – changes to existing registration data flows to include the passing of Clearing Houses' Party IDs and new role code from the CRA to the ECVAA. Additional changes to reflect the new data flow from the ECVAA to Clearing Houses.

- New qualification BSCP being progressed via CP502 – potential changes required if the new BSCP is implemented before or with P146, in order to reflect the new participation category of Clearing House.
- Communications Requirements Document – addition of processes by which a Clearing House notifies BSCCo of an e-mail address to be used for notifications regarding Credit Default, and for deeming receipt of such notifications.

### **Alternative Modification**

The Alternative Modification P146 would impact the following Code Subsidiary Documents:

- BSCP65 – addition of new Clearing House subcategory of Trading Party and associated Market Entry and Market Exit processes.
- New qualification BSCP being progressed via CP502 – potential changes required if the new BSCP is implemented before or with P146, in order to reflect the new participation category of Clearing House.

## **5.3 Configurable Items**

### **Proposed Modification**

The Proposed Modification P146 would impact the following Configurable Items:

- IDD Part 1 – changes to reflect the new interface between the ECVAA and Clearing Houses.
- CRA Manual System Specification – changes to reflect the new Party ID role code for Clearing Houses.
- CRA Operational Services Manual – as above.
- CRA Local Working Instructions – as above.
- ECVAA User Requirements Specification – changes to reflect the new search to match a Party in breach of its Credit Cover Percentage with any authorisations between that Party and a Clearing House. Additional changes to reflect the processes by which the ECVAA alerts BSCCo of such authorisations at the time of the breach, and by which BSCCo instructs the ECVAA whether to notify a Clearing House at the end of a Query Period.
- ECVAA Service Description – as above.
- ECVAA System Specification – as above.
- ECVAA Design Specification – as above.
- ECVAA Local Working Instructions – as above.

### **Alternative Modification**

No configurable items are impacted by the Alternative Modification.

## **5.4 BSCCo Memorandum and Articles of Association**

No impact identified.

## **5.5 Impact on Core Industry Documents and Supporting Arrangements**

No impact identified.

## 6 SUMMARY OF CONSULTATION RESPONSES

	Consultation Question	Yes	No	No Comment
1	Do you believe that the Proposed Modification P146 better facilitates the achievement of the Applicable BSC Objectives?	1	6	1
2	Do you believe that an Alternative Modification consisting only of the new participation category and charging aspects of P146 (i.e. with the potential Credit Default warning provisions removed) would better facilitate the achievement of the Applicable BSC Objectives?	5 (2 qualified)	2	1
3	Which, if any, of the five qualification criteria options outlined in Section 2.1.2 of the consultation document do you believe should be applied to the new participation category of Clearing House?	2 respondents in favour of Option 1 3 respondents in favour of Option 2 1 respondent in favour of either Option 2 or Option 3 2 respondents had no comment No respondents in favour of Options 4 or 5		
	Are there any additional or alternative criteria that you believe should be considered?	0	0	8
4	Do you agree with the view of the Proposer that P146 would result in increased use of Clearing Houses under the Code?	3	3	2
5	Do you support the implementation approach described in the consultation document?	4	2	2
6	Do you believe there are any alternative solutions that the Modification Group has not identified and that should be considered?	0	7	1
7	Does P146 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?	0	7	1

### 6.1 Modification Group's Summary of the Consultation Responses

The SSMG expressed disappointment that only three of the responses received were from Parties who were not members of the Modification Group, and that The London Clearing House had declined to respond to the consultation. The SSMG noted that the responses therefore largely mirrored the discussions of the Group. A summary of the consultation responses is provided below, and the SSMG's consideration of these arguments can be found in Sections 1.4 and 1.7.

#### Q1 Do you believe that the Proposed Modification P146 better facilitates the achievement of the Applicable BSC Objectives?

Six respondents (37 Parties) did not believe that the Proposed Modification would better facilitate achievement of the Applicable BSC Objectives, and would have a negative impact upon competition and

Objective (c). The arguments expressed by these respondents were that the Credit Default provisions of the Proposed Modification would provide Clearing Houses with a commercial advantage, discriminate against the rest of the market, reduce the effectiveness of the existing Level 1 default cure period, and potentially worsen the position of both the Party in breach of its Credit Cover Percentage and of its other counterparties.

One of these respondents (14 Parties) did not believe there to be a defect in the Code relating to Clearing Houses, and therefore did not support either the Proposed or Alternative Modifications.

However, one respondent (representing the Proposer and one other Party) believed that the Proposed Modification would better facilitate competition and Applicable Objective (c). This respondent argued that the Code should act to promote clearing services through implementation of the Proposed Modification, since such services provide a number of benefits to the market – allowing netting of trades across counterparties to minimise collateral, enabling more Parties to trade with each other and thus lowering barriers to entry, and reducing the number of bilateral trades (and thereby increasing efficiency).

One respondent (1 Party) had no comment.

**Q2 Do you believe that an Alternative Modification consisting only of the new participation category and charging aspects of P146 (i.e. with the potential Credit Default warning provisions removed) would better facilitate the achievement of the Applicable BSC Objectives?**

3 respondents (13 Parties) believed that this potential Alternative, consisting of a new participation category and halved Notified Volume Charging for Clearing Houses, would better facilitate competition and Applicable Objective (c). The arguments expressed were that this approach would be more supportable, and would correct an anomaly contained in the current Notified Volume charging structure applied to Clearing Houses.

1 respondent (6 Parties) expressed qualified support for the potential Alternative, whilst another (1 Party) was undecided. Both these respondents (who were also members of the SSMG) noted that the current Notified Volume Charge for Clearing Houses appears anomalous, and therefore supported halving such charges for Clearing Houses in principle. However, these respondents considered that the Alternative would only have a beneficial impact on the rest of the market and Objective (c) if there was any corresponding reduction in Clearing Houses' charges to their own members. In the final recommendation of the SSMG to the Panel, one of these respondents decided to recommend that the Alternative Modification should be made whilst one recommended that it should not be made.

2 respondents (19 Parties) did not believe that such an Alternative would better facilitate achievement of the Applicable BSC Objectives, and would have a negative impact on competition and Objective (c). These respondents expressed the view that halving Notified Volume Charges for Clearing Houses would mean that all other BSC Parties would effectively be subsidising half of Clearing House notifications, regardless of whether these Parties utilised the services of Clearing Houses.

One respondent (1 Party) had no comment.

**Q3 Which, if any, of the five qualification criteria options outlined in Section 2.1.2 of the consultation document do you believe should be applied to the new participation category of Clearing House? Are there any additional or alternative criteria that you believe should be considered?**

Four respondents (14 Parties) considered that Option 2 should be adopted for the Proposed Modification. The views expressed were that P146 should include all organisations offering clearing services and regulated by the FSA. One of these respondents (9 Parties) also supported Option 3, which would require an Alternative Modification. However, 2 of these respondents who were also members of the SSMG later altered their views to favour Option 1 for the Proposed Modification in light of concerns regarding the Credit Default provisions of P146 (see Section 1.3.4). These respondents continued to support Option 2 for the Alternative Modification.

2 respondents (11 Parties) supported Option 1, and believed this set of criteria to be the most appropriate and efficient whilst the least open to potential abuse.

1 respondent (14 Parties) did not support any of the suggested options, since they did not support either the Proposed or potential Alternative Modifications. However, this respondent considered that if the Modification was implemented then they would prefer a narrow and/or stringent set of criteria.

No support was expressed for Options 4 or 5.

One respondent (1 Party) had no comment.

**Q4 Do you agree with the view of the Proposer that P146 would result in increased use of Clearing Houses under the Code?**

Three respondents (13 Parties) believed that P146 would result in increased use of Clearing Houses. One of these respondents (representing the Proposer and one other Party) argued that P146 would remove existing barriers to provision of clearing services. Another respondent (2 Parties) considered that there would be an increased use of Clearing Houses if their cost-savings under P146 were passed on to members.

Three respondents (21 Parties) did not believe that P146 would result in increased use of Clearing Houses, since there was no guarantee that any cost-saving would be passed on to the market through reduced charges to members. Moreover, two of these respondents (15 Parties) considered that Notified Volume Charges are only a subset of the costs involved in using clearing services, and doubted whether they represented a barrier to use of Clearing Houses.

Two respondents (6 Parties) had no comment.

**Q5 Do you support the implementation approach described in the consultation document?**

Two respondents (15 Parties) had no comment on the implementation approach proposed by the SSMG. The 'no comment' of one of these respondents (14 Parties) reflected the fact that this respondent did not support either the Proposed or Alternative Modifications – and their response indicated that, if the Proposed Modification was approved, the suggested semi-manual approach should be adopted.



Two respondents (6 Parties) did not support the implementation approach outlined in the consultation document since neither respondent supported the Proposed Modification (one of these respondents, representing 5 Parties, additionally did not support the Alternative).

Three respondents (19 Parties) supported the proposed implementation approach.

**Q6 Do you believe there are any alternative solutions that the Modification Group has not identified and that should be considered?**

No respondents to the consultation believed there to be any alternative solutions not already considered by the SSMG.

One respondent (1 Party) had no comment.

**Q7 Does P146 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?**

No respondents believed there to be any issues arising from P146 which had not already been identified and considered by the SSMG.

However, 3 respondents (12 Parties) queried any implications for P146 resulting from APX's acquisition of UKPX (see Section 1.3.4 for the SSMG's consideration of this issue).

One respondent (1 Party) had no comment.

## **6.2 Comments and Views of the Modification Group**

The SSMG identified the following new arguments raised by the consultation responses:

- One respondent (representing the Proposer and one other Party) commented that the Market Index Definition Statement (MIDS) currently recognises that a cleared trade is not the same as two separate trades, and therefore argued that this should be reflected in the Notified Volume Charges applied to Clearing Houses. The SSMG clarified that this recognition by the MIDS relates only to how cleared trades contribute to the Market Index Price, and therefore agreed (with the exception of the Proposer) that such reference could not necessarily be used as justification for charging changes for Clearing Houses.
- The same respondent noted that, under Approved Modification P98 'Dual Notification of Contract Positions', Parties using dual notification will continue to pay the same level of charges as those using single notification. The respondent therefore argued that this recognised the low 'incremental' cost of the 'extra' ECVNs, and that the same logic should be applied to the 'doubled' notifications submitted by Clearing Houses. The SSMG noted that although two ECVNs would be submitted under dual notification, only one volume would enter Settlement – whereas, in a cleared trade, the cleared volume is the subject of two ECVNs and enters Settlement twice. The view of the SSMG was split regarding whether the dual notification model could be used as justification for halving Clearing Houses' Notified Volume Charges, and this reflected the arguments outlined in Section 1.7 above.
- The same respondent also argued that the Proposed Modification would minimise the risk of Credit Default to the market as a whole, regardless of whether individual Parties used Clearing Houses or not. However, the SSMG (with the exception of the Proposer) considered that, by

undermining the value of the current cure period, the Proposed Modification would actually serve to increase the risk to the rest of the market.

- The same respondent argued that it may be easier for some smaller Parties to trade through a Clearing House than through bilateral agreements since such Parties would only have to lodge margin once with the Clearing House rather than separate collateral with its counterparties. The SSMG considered this view, but recognised that it was difficult to compare the costs of lodging margin with a Clearing House with the cost of raising any collateral for a bilateral trade – since such costs lie outside the Code, and there are additional fees paid by Clearing House members for use of their services. The Group were undecided as to whether P146 would increase the use of Clearing Houses (see discussion of Question 4 above). However, one member argued that there appears to be an increasing market desire to use Clearing Houses due to the cost-effectiveness of clearing services.
- One respondent (1 Party) argued that providing early warning of potential Credit Defaults to Clearing Houses might result in 'forced' trades, which would impact the reverse price or spot market price calculations. The SSMG noted this view, and the alternative argument of one member that increased use of Clearing Houses who were also MIDPs (such as APX and UKPX) might improve liquidity and lead to a better Market Index Price. Again, the view of the SSMG was split as to whether charging reductions for Clearing Houses would result in increased use of clearing (see Section 1.7).
- One respondent (5 Parties) argued that Options 1 or 2 would not set a precedent by including external legislation and regulation as Code qualification criteria, since the FSA and Ofgem are both government agencies and are effectively 'mirror' bodies since they are established on the same basis. The SSMG accepted this clarification, but agreed that reference to the FSA still represented a precedent since all current participation capacities referring to external recognition take the form of licenses granted by Ofgem.

The SSMG agreed that all the new arguments raised by the consultation had been addressed.

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

A Transmission Company Analysis and Impact Assessment was commissioned during the Assessment Procedure for P146. No impact was identified that would affect the ability of the Transmission Company to discharge its obligations under the Transmission Licence.

The Transmission Company did not express an opinion as to whether P146 would better facilitate the Applicable BSC Objectives.

The Transmission Company did not believe that P146 would impact any of its systems or processes, or require any consequential changes to Core Industry Documents.

## **8 SUMMARY OF EXTERNAL ADVICE**

None commissioned.

## 9 IMPLEMENTATION APPROACH

The SSMG agreed that:

- The Proposed Modification requires changes to Central Systems and should be implemented as part of a wider Systems Release as the most cost-effective and efficient approach, since it avoids incurring the full costs of a stand-alone Release (see Annex 4).
- The Alternative Modification, although requiring no Central Systems changes, incurs BSCP amendments and should therefore also be implemented as part of a wider Release on the same cost and efficiency grounds.
- This approach is consistent with BSCCo's Release Strategy.

The SSMG noted that:

- The full scope of the June 04 Release has now been fixed.
- The scope of the system changes required for the November 04 Release will be fixed in April 2004, with the result that the first Release which could potentially incorporate the Proposed Modification would be February 05.
- However, the Alternative Modification requires no Central Systems changes and could be considered for inclusion in the November 04 Release.

The SSMG therefore agreed the following provisional Implementation Dates:

### Proposed Modification

- 23 February 2005 if an Authority Decision is received on or before 22 June 2004; or
- 29 June 2005 if an Authority Decision is received after 22 June 2004 but on or before 28 October 2004.

### Alternative Modification

- 3 November 2004 if an Authority Decision is received on or before 27 July 2004; or
- 23 February 2005 if an Authority Decision is received after 27 July 2004 but on or before 16 November 2004.

## 10 DOCUMENT CONTROL

### 10.1 Authorities

Version	Date	Author	Reviewer	Change Reference
0.1	28/01/04	Kathryn Coffin	Roger Salomone	Chairman Review
0.1	28/01/04	Kathryn Coffin	SSMG	SSMG Review
0.2	04/02/04	Kathryn Coffin	Change Delivery	Technical and Quality Review
1.0	06/02/04	Change Delivery		Panel Decision

## ANNEX 1 DRAFT LEGAL TEXT

- No draft legal text has been provided for the Proposed Modification.
- Draft legal text for the Alternative Modification is included as Annex 1A, and is attached as a separate document.

## ANNEX 2 MODIFICATION GROUP DETAILS

Member	Organisation	Meetings Attended
Sarah Parsons	ELEXON (Chair)	1
Roger Salomone	ELEXON (Chair)	3
Kathryn Coffin	ELEXON (Lead Analyst)	4
Ben Mitchell	OM London Exchange (Proposer)	3
Steve Drummond	EdF Trading	4
Man Kwong Liu	Scottish Power	2
Mark Manley	BGT	4
Ian Moss	APX	3
Sanjupta Round	Cornwall Consulting	3
Neil Smith	Powergen	4
Ben Willis	Npower	1

Attendee	Organisation	Meetings Attended
Lisa Deverick	ELEXON (Legal Advisor)	3
Neil Cohen	ELEXON (Analyst)	2
David Edward	Ofgem	3
Steve Mackay	Ofgem	1
Lisa Ashford	OM London Exchange (Proposer's Alternate)	1
Joanne Ellis	Cornwall Consulting	1
Martin Mate	British Energy	2
Barbara Vest	Gaz de France	1

### SSMG Terms of Reference (Version 1.0) - Annex for Modification Proposal P146

Modification Proposal P146 will be considered by the Settlement Standing Modification Group (SSMG) in accordance with the SSMG Terms of Reference.

The Modification Group will carry out an Assessment Procedure in respect of Modification Proposal P146 pursuant to section F2.6 of the BSC.

The Modification Group will produce an Assessment Report for consideration at the BSC Panel Meeting on 12 February 2004.

The Modification Group shall consider and/or include in the Assessment Report as appropriate:

**Principle of discrimination** – whether the changes proposed by P146 would provide Clearing Houses with a commercial advantage, and therefore discriminate against other Parties and wider competition, or if Clearing Houses represent a unique case for receiving the benefits of P146.

**Distinctiveness of Clearing Houses from other Trading Parties** – central to the above is the need to establish a definition of 'Clearing House' and assess its distinctiveness from other Parties. Non-physical traders or portfolio players in particular may seek to balance their position in a similar manner, and may therefore be subject to the same risks and charges.

**Code definition of 'Clearing House'** – establishment of the Code criteria under which Parties would hold the new participation capacity of Clearing House. Parties currently accede to the Code in one or more of the capacities outlined in Paragraph A1.3; however P146 proposes that Parties registered under the new capacity of Clearing House would not be entitled to act in any other role. If there are currently situations in which a single BSC Party functions both as a Clearing House and as another kind of non-physical trader, the implications of P146 for such Parties will therefore need to be examined. Consideration is also required regarding whether P146 would provide incentives for other Trading Parties (or their subsidiaries) to register as Clearing Houses.

**Code definition of 'Trading Party'** – whether this definition would require amendment so that Clearing Houses would not be deemed to be Trading Parties, or if Clearing Houses would become a subset of Trading Party. Currently the Code defines a Trading Party as a Party, other than the Transmission Company, which holds Energy Accounts.

**Regulatory requirements upon Clearing Houses** – consideration of the robustness of these requirements and whether they result in a unique market role for Clearing Houses. Discussion will also be required regarding the principle of introducing a participation capacity into the Code where the criteria to act in such a capacity (i.e. the holding of a Clearing House license) falls outside of Ofgem's regulation.

**Current arrangements in the gas market** – clarification of the role of Clearing Houses under the Network Code, and whether this role should be similarly reflected within the BSC arrangements as suggested by the Proposer.

**Parties for whom Clearing Houses would receive ECVAAs notifications of Credit Default** - P146 is ambiguous regarding which Parties in Credit Default would be notified to Clearing Houses by the ECVAAs. The Proposer states in the 'Description of the Proposed Modification' that the ECVAAs would provide notifications relating to those Parties for whom the Clearing House had already submitted ECVNs. However, when describing the impact of P146 upon the Code, the Proposer states that notifications will be provided regarding Parties for whom the Clearing House is *authorised* to submit ECVNs. Since the submission of the IWA, the Proposer has clarified that the intention of P146 is that a Clearing House should receive notice in respect of those Parties for whom the Clearing House is authorised to submit notifications, regardless of whether notifications have actually been submitted. This information may or may not be currently held by the ECVAAs, depending on what is meant by authorisation in this context.

**Timing and commercial sensitivity of Credit Default information** – whether, under P146, Clearing Houses would receive Credit Default information prior to its publication on the Balancing Mechanism Reporting Service (BMRS) and thereby gain a commercial advantage.

Currently, all Parties are informed via the BMRS when an authorisation notice for Level 1 or Level 2 Credit Default has been given by BSCCo to the ECVAAs. For Level 1 this occurs at the end of the default

cure period following the Level 1 Query Period, and for Level 2 immediately following the end of the relevant Level 1 Query Period. However, the Proposer states that under P146 the ECVAAs should inform a Clearing House of Level 1 Credit Defaults at the end of the Query Period and of Level 2 Credit Defaults 'with immediate effect'. P146 would therefore result in a Clearing House receiving Level 1 information before other Parties at a time when the Party concerned would be in potential, rather than actual, Default. In addition, Clearing Houses would receive early warning of potential Level 2 Credit Defaults if 'immediate effect' is taken to mean that notification would be provided as soon as the Party breached 90% of its Credit Cover Percentage. Under circumstances where a Party manages to resolve its potential Default before an authorisation is given (so that no actual Default takes place), Clearing Houses would receive information not made available to Parties.

Since the submission of the IWA, the Proposer has confirmed that the intention of P146 is for Clearing Houses to receive notice of a Credit Default before confirmation of the Default is made available to all Parties via the BMRS. Consideration will therefore need to be given as to whether it is appropriate for Clearing Houses to have access to such information, and its implications for commercial confidentiality and trading. All Parties are exposed to risks and uncertainties regarding the credit-worthiness of counter-parties, and an argument as to why such risks should be mitigated only for Clearing Houses would need to be established.

**Exception from Notified Volume Charge for negative energy volumes** – whether it would be appropriate for Clearing Houses to pay only the charges relating to positive energy volumes, since other Parties who are not Clearing Houses may be subject to both positive and negative energy volume charges and may therefore be disadvantaged by P146. BSCCo's published Business Strategy and Annual Budget for 2003-2006 has estimated that it will recover 3.9% of BSC costs annually via Notified Volume Charges. Any shortfall in charging resulting from P146 would be recouped via BSCCo's Monthly Funding Shares.

**Impact on BSC Agent systems and processes** – a Detailed Level Impact Assessment will be required from the BSC Agent since P146 requires changes to CRA and ECVAAs systems and processes.

**Additional points raised by the BSC Panel on 13 November 2003**

- whether changing the Code is appropriate or whether the issues could be addressed via a contractual route (i.e. between the Clearing House and its members);
- whether there is merit in progressing the Credit Default or Notification Charging aspects separately as an Alternative Modification; and
- whether there would be a conflict of interest between the Code and Clearing Houses or if P146 could introduce a mutually beneficial relationship.

### **ANNEX 3 CONSULTATION RESPONSES**

#### **Responses from P146 Assessment Consultation**

Consultation issued 18 December 2003

Representations were received from the following parties:

<b>No.</b>	<b>Company</b>	<b>File Number</b>	<b>No. BSC Parties Represented</b>	<b>No. Non-Parties Represented</b>
<b>1.</b>	Powergen	P146_ASS_001	14	0
<b>2.</b>	Aquila Networks	P146_ASS_002	1	0
<b>3.</b>	British Gas Trading	P146_ASS_003	1	0
<b>4.</b>	APX/OM London Exchange	P146_ASS_004	2	0
<b>5.</b>	Scottish and Southern Energy	P146_ASS_005	5	0
<b>6.</b>	Scottish Power	P146_ASS_006	6	0
<b>7.</b>	EDF Trading	P146_ASS_007	2	0
<b>8.</b>	EDF Energy Networks	P146_ASS_008	9	0

**P146\_ASS\_001 – Powergen UK Plc**

<b>Respondent:</b>	<i>Powergen UK plc</i>
<b>No. of BSC Parties Represented</b>	<i>14</i>
<b>BSC Parties Represented</b>	<i>Please list all BSC Parties responding on behalf of (including the respondent company if relevant). Powergen UK plc, Powergen Retail Limited, Cottam Development Centre Limited, TXU Europe Drakelow Limited, TXU Europe Ironbridge Limited, TXU Europe High Marnham Limited, Midlands Gas Limited, Western Gas Limited, TXU Europe (AHG) Limited, TXU Europe (AH Online) Limited, Citigen (London) Limited, Severn Trent Energy Limited (known as TXU Europe (AHST) Limited), TXU Europe (AHGD) Limited and Ownlabel Energy</i>
<b>No. of Non BSC Parties Represented</b>	<i>0</i>
<b>Non BSC Parties represented</b>	<i>0</i>
<b>Role of Respondent</b>	Supplier, Generator, Trader and Exemptable Generator

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
1.	Do you believe that the Proposed Modification P146 better facilitates the achievement of the Applicable BSC Objectives? Please give rationale and state objective(s).	NO	Early notification of Credit Default information would provide Clearing Houses with a commercial advantage and would therefore have an adverse effect on Objective (c). An early notification of Default would allow Clearing Houses to trade out of a position before the rest of the market is aware that a potential problem exists. All parties are exposed to the risk associated with the credit worthiness of counterparties. However, to release early information to a particular party and thereby reduce that party's level of risk (compared to others in the same market) must surely be considered as discriminating and therefore detrimental to competition. The proposer argues that Clearing Houses require an early notification to enable them to assist the relevant Party by offering advice, thereby seeking to reduce the potential for credit default. However it must be remembered that Clearing Houses are themselves commercial organisations and their priority is their own commercial position. As such, it is more likely that an early notification would only serve to reduce the effectiveness of the existing Credit Default Cure Period.



	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
			<p>Powergen also believe that the introduction of a single notified volume charge for Clearing Houses will not better meet applicable Objective (c). It is misleading to claim that Clearing Houses are discriminated against because they are required to pay for two notifications. The notification fee was designed to recover the cost of processing an ECVN and as the Clearing House makes two notifications it is reasonable to suggest that they pay for two notifications. Regardless, Clearing Houses generally pass the charges through to their members. However, it is far from clear that there would be a corresponding cost reduction for their members should Notified Volume Charges be halved for Clearing Houses.</p> <p>A reduction in the fees charged to the Clearing Houses would need to be recovered through the Main Funding Shares and this would result in cross-subsidy (Please see answer to Q2).</p>
2.	<p>Do you believe that an Alternative Modification consisting only of the new participation category and charging aspects of P146 (i.e. with the potential Credit Default warning provisions removed) would better facilitate the achievement of the Applicable BSC Objectives?</p> <p>Please give rationale and state objective(s).</p>	NO	<p>Powergen believe that the proposed alterations to the charging methodology would not better facilitate achievement of the applicable objective. If such a modification were to be approved, there would be a shortfall which would need to be recovered from the Main Funding Shares. This would mean that all other Parties would be subsidising half of all Clearing House notifications, regardless of whether they utilised the services of Clearing Houses. It should also be noted that Clearing Houses do not pay Main Funding Shares and would not fund any of these additional costs. There is no justification for introducing such a cross subsidy.</p>
3.	<p>Which, if any, of the five qualification criteria options outlined in Section 2.1.2 do you believe should be applied to the new participation category of Clearing Houses?</p> <p>Are there any additional or alternative criteria that you believe should be considered?</p>	N/A	<p>We do not consider P146 to better facilitate the applicable objectives and so can not support any particular option. However, we would stress that should the modification be successful, a narrow/stringent criteria would be preferable.</p>

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
	Please give rationale.		
4.	Do you agree with the view of the Proposer that P146 would result in increased use of Clearing Houses under the Code? Please give rationale.	NO	Although reduced charges may encourage Parties to use Clearing Houses, there is no guarantee that the cost savings for the Clearing Houses will be passed on to their members.  It is also unlikely that the current charges act as a barrier for potential Clearing Houses, as the Volume Notification costs are passed through to members. If Clearing Houses provide a useful function Participants will use them.
5.	Do you support the implementation approach described in the consultation document? Please give rationale.	N/A	Should the modification be implemented; we agree with the modification group that the semi-manual solution is the appropriate mechanism as it represents the most cost effective solution.
6.	Do you believe there are any alternative solutions that the Modification Group has not identified and that should be considered? Please give rationale.	NO	We do not believe there to be a defect in the code.
7.	Does P146 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure? Please give rationale.	NO	We do not believe there to be a defect in the code.
8.	Are there any further comments on P146 that you wish to make?	NO	

**P146\_ASS\_002– Aquila Networks Plc**

Aquila Networks PLC would like to return a response of 'No Comment' to P146 Assessment Consultation.

Regards,

Deborah Hayward  
Distribution Support Office &  
Deregulation Control Group  
Aquila Networks plc

**P146\_ASS\_003– British Gas Trading**

<b>Respondent:</b>	<b>Mark Manley</b>
<b>No. of BSC Parties Represented</b>	
<b>BSC Parties Represented</b>	<b>British Gas Trading (BGT)</b>
<b>No. of Non BSC Parties Represented</b>	
<b>Non BSC Parties represented</b>	
<b>Role of Respondent</b>	

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
1.	Do you believe that the Proposed Modification P146 better facilitates the achievement of the Applicable BSC Objectives? Please give rationale and state objective(s).	No	BGT do not believe that the Proposed Modification better facilitates the achievement of the Applicable BSC Objectives. BGT do not support Clearing Houses having access to Credit Default information before other BSC Parties. Providing Clearing Houses with early notification will be to the detriment of both Applicable BSC Objective (c) and (d).  Providing Clearing Houses with advance warning of potential Level 1 Credit Default will provide Clearing Houses with information that is not available to other BSC Parties. This will have a negative impact on competition as it will allow Clearing Houses to better manage their credit risks as they will be

	Question	Response	Rationale
			<p>privity to information that is not publicly available. Whilst Clearing Houses may not seek to profit from price changes they will be looking to offset their exposure and this could be achieved at the expense of other BSC Parties who may have a financial exposure to the Party going into Level 1 Credit Default.</p> <p>Also the information that the proposal is seeking to provide is at the end of the Query Period and not the Cure Period and could have a distortionary impact on competition. A Party is not in Level 1 Credit Default until the end of the Cure Period and any 'forced' trades that take place may feed into the calculation of the reverse price or may impact on the spot market price. The credit process is a two step process and providing information before that two step process is completed is unjustified.</p> <p>In respect of objective (d) the notification of this information will require a new process to be created. This will incur a cost that will be borne by BSC Parties. This cost irrespective of its size is not justifiable especially when this process could be achieved via a bi-lateral process between Clearing House and its' members.</p> <p>BGT are unsure if the level of potential benefits is sufficiently large as to better facilitate competition in the generation and supply of electricity. The cost savings that have been identified appear to be relatively minor and BGT would be surprised if such a minor benefit resulted in increased use of clearing. In addition to this the cost structure of Clearing Houses is outside of the scope of the BSC and any reduction in charges does not have to be passed on to Clearing House members.</p>
2.	Do you believe that an Alternative Modification consisting only of the new participation category and charging aspects of P146 (i.e. with the potential Credit Default warning provisions removed) would better facilitate the achievement of the Applicable BSC		BGT believe there may be some merit in considering an alternative that only incorporates the new participation category and the charging elements. BGT support the principle of reducing the number of contract notification charges from 4 to 3. The current charging structure seems to be anomalous and there appears to be some justification in reducing the

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
	Objectives? Please give rationale and state objective(s).		number of charges. However BGT is still unsure if the alternative would better facilitate competition in the generation and supply of electricity.
	Which, if any, of the five qualification criteria options outlined in Section 2.1.2 do you believe should be applied to the new participation category of Clearing Houses? Are there any additional or alternative criteria that you believe should be considered? Please give rationale.	Option 2	<p>BGT's favoured option is qualification criteria of a Recognised Body or Authorised Firm supplemented with criteria in the BSC. Option 2 provides an appropriate balance of obligations in the BSC and external checks via the FSA. Whilst recognising this option will require some monitoring by BSCCo it is sufficiently flexible without being too constrained.</p> <p>BGT believe option 1 and 4 are too restrictive, if this modification is deemed to facilitate competition then the definition needs to be wider than just the proposer in the new category.</p> <p>Option 5 appears not to be stringent enough and may enable Traders to apply for Clearing House status. This is clearly outside of the intention of the original modification proposal and may result in Parties who seek to make profit from price movements falling within the category.</p>
	Do you agree with the view of the Proposer that P146 would result in increased use of Clearing Houses under the Code? Please give rationale.	No	<p>On the basis of the negligible savings identified in the Assessment Consultation document BGT do not believe that a reduction in the contract notification structure for Clearing Houses would necessarily result in increased usage of clearing services.</p> <p>The contract notification charges are only a subset of the costs involved in using clearing services. The cost of lodging margin after having to lodge credit with BSCCo and NGC might be seen as more of a barrier to the use of clearing services.</p>
	Do you support the implementation approach described in the consultation document? Please give rationale.	No	BGT do not support the implementation approach outlined in the consultation as it includes the provision of early notification of 80 per cent breaches in energy indebtedness.

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
	Do you believe there are any alternative solutions that the Modification Group has not identified and that should be considered? Please give rationale.	No	
	Does P146 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure? Please give rationale.	No	
	Are there any further comments on P146 that you wish to make?	Yes	Does the sale of the UKPX business have any impact on the modification that may need to be considered?

#### **P146\_ASS\_004 – Amsterdam Power Exchange UK Ltd, OM London Exchange Ltd**

<b>Respondent:</b>	<i>Ben Mitchell</i>
<b>No. of BSC Parties Represented</b>	<i>2</i>
<b>BSC Parties Represented</b>	<i>Amsterdam Power Exchange UK Ltd, OM London Exchange Ltd</i>
<b>No. of Non BSC Parties Represented</b>	<i>0</i>
<b>Non BSC Parties represented</b>	
<b>Role of Respondent</b>	Trading Party

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
1.	Do you believe that the Proposed Modification P146 better facilitates the achievement of the Applicable BSC Objectives? Please give rationale and state objective(s).	Yes	The BSC fails to recognise the role that clearing participants serve in the UK electricity market, and consequently the Code fails to appropriately provide for and regulate the operation of clearing operations. P146 addresses and remedies these defects in the BSC, and will promote the role of clearing in the industry, which will increase the competitiveness and efficiency of the trading of electricity in the UK. However, it is important that the definition of "clearing participant" under P146 includes

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
			<p>all bodies supplying clearing services to the UK power market (see Q3 below).</p> <p>The submission of two nominations for each cleared trade is essential for the preservation of anonymity of the clearing service users. However, this means that a trade between two parties that is subsequently cleared results in twice the notification fees being levied by Elexon.</p> <p>The BSC, in the Market Index Definition Statement, recognises that when a trade is cleared, it does not become two trades and this should be reflected in the ECVAA charges. ECVAA charges are based on the number of MWh notified, and not on the number of ECVN files submitted, (e.g. a party submitting ten files each for 1 MWh, pays the same as a party submitting one file containing 10 MWh. In addition P98 will result in those parties that undertake dual notification paying no more than they would have, had only a single file been submitted). So that fact that two files are submitted is not relevant, the traded volume should be recognised as the volume of the trade that is cleared, and not doubled for the purposes of charging.</p> <p>Clearing services are prevalent in most mature traded markets. They provide a number of distinct benefits to the market, e.g. by allowing netting of trades across counterparties to minimise collateral; enabling more parties to trade with each other and thus lowering the barriers of entry to the market; and, improving the efficiency of the market arrangements by reducing the number of bilateral agreements.</p> <p>It is essential that the BSC does not discriminate against clearing parties, and where practicable facilitates their role. The proposed modification achieves this by removing the anomaly in the ECVAA charges and allows for better management of credit within the industry. The proposed modification will therefore better facilitate BSC Objective (c).</p>

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
2.	Do you believe that an Alternative Modification consisting only of the new participation category and charging aspects of P146 (i.e. with the potential Credit Default warning provisions removed) would better facilitate the achievement of the Applicable BSC Objectives? Please give rationale and state objective(s).	Yes	it should be noted that the notification charging provisions of P146 would operate independently to the credit default provisions of the proposed modification, and therefore the alternative modification is a practical proposition. Although some benefit is lost under the alternative modification, the rationale for removing the double charging under the original modification is the same under the proposed alternative modification and hence will still better facilitate the BSC objective (c).
3.	Which, if any, of the five qualification criteria options outlined in Section 2.1.2 do you believe should be applied to the new participation category of Clearing Houses? Are there any additional or alternative criteria that you believe should be considered? Please give rationale.	2	It is the role of providing clearing services that improves the efficiency of the market, not that a party is necessarily an RIE or RCH. It would be discriminatory to exclude companies such as APX that provide the same clearing services. It is important that the Code defines the role being undertaken, rather than simply relying on an external organisation, (the FSA), to effectively grant privileges under the BSC. The code criteria provides the assurance that the clearing service provider does not trade energy for profit and is purely providing the role of clearing body under the BSC, which is the intent of the proposed modification.  However, regulation by the FSA will provide additional comfort to BSC Parties that those organisations providing clearing services do operate to certain recognised rules and standards.
4.	Do you agree with the view of the Proposer that P146 would result in increased use of Clearing Houses under the Code? Please give rationale.	Yes	The current notification charging structure effectively means bodies providing clearing services to the UK power industry are being charged a double fee for the notification of positions they clear. This plainly has an impact on the cost base of clearing service providers, undermining the sustainability of such bodies and impeding the development and use of clearing.  Furthermore, the credit default provisions of the proposed modification will encourage clearing participants to offer their services more widely, thereby increasing the potential use of such services. In addition, these provisions will enable clearing service providers to use a market-based



	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
			solution for the alleviation of credit default situations, increasing the attractiveness, and therefore the use, of such services.
5.	Do you support the implementation approach described in the consultation document? Please give rationale.	Yes	<p>The occurrence of credit defaults that will be relevant to the provisions of P146 is likely to be low. Furthermore, the MWh volume of notifications submitted to the ECVAA by clearing bodies will tend not to vary considerably month on month. Accordingly a semi-manual solution will not present a high level of risk.</p> <p>The required solution to implement P146 should not be a stand-alone release, but should be packaged with another release.</p>
6.	Do you believe there are any alternative solutions that the Modification Group has not identified and that should be considered? Please give rationale.	No	
7.	Does P146 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure? Please give rationale.	No	
8.	Are there any further comments on P146 that you wish to make?	Yes	<p>Credit constraints have a substantial negative impact on the operation of the UK electricity market. Trading participants are often unable to transact at the best price shown to the market, or may not be able to transact at all, due to congested or non-existent credit lines. This hinders the efficient conduct of trading, impedes the price discovery function of the market and has the potential to increase the likelihood of credit defaults (as distressed parties may not be able to trade with anybody, should the market fear that they are an unacceptable credit risk).</p> <p>The increased use of clearing would minimise the impact of such credit constraints, and would accordingly be of value to the UK electricity trading community as a whole, irrespective of whether the individual participant makes use of such clearing services or not. Clearing enables trading to be</p>

	Question	Response	Rationale
			based on fundamentals, and provides a level playing field for all market participants. P146 will promote the role of clearing within the industry, and therefore is of value to all parties involved in the UK power market.

### **P146\_ASS\_005 – Scottish and Southern Energy**

This response is sent on behalf of Scottish and Southern Energy, Southern Electric, Keadby Generation Ltd., Medway Power Ltd., and SSE Energy Supply Ltd.

In relation to the eight questions contained within your note of 18th December 2003, and the associated Assessment Consultation for P146, we have the following comments to make:-

#### **Q1 Do you believe that the Proposed Modification P146 better facilitates the achievement of the Applicable BSC Objectives? Please give rationale and state objective(s).**

No. We do not believe that the Proposed Modification P146 better facilitates the achievement of the Applicable BSC Objectives.

We note the comments made in section 2.1.4 of the Assessment Consultation document that:-

"Some members therefore noted that, aside from proof of recognised or regulated status under the FSA, regulation of the Code criteria for Clearing Houses might be reliant upon self-certification by the party concerned. This would take the form of a signed undertaking by each registering Clearing House to comply with the criteria, and to notify BSCCo if at any time it became unable to do so. These members argued that Options 2 and 3 would create the risk of a large number of existing organisations meeting the requirement to be an authorised firm, with BSCCo being largely reliant on their self-certification if such parties applied to be Clearing Houses. These members considered that this was highly inadvisable given the benefits P146 would grant to the new category. Other members of the SSMG argued that, for all three options, BSCCo should be required to put in place processes to monitor Clearing Houses' compliance with the criteria. However, the Group did not reach agreement regarding how a Clearing House's ownership would be monitored, the process to be followed if a gross position was held by a Clearing Party, or how the holding of a gross position could be established as accidental or intentional with regard to the criteria."

We believe that "given the benefits P146 would grant to the new [Clearing House] category", the reliance on self certification, the lack of clarity on dealing with gross positions held by a Clearing Party and the inability to determine if a gross position was established accidentally or intentionally means that this Modification Proposal would be detrimental to competition and would therefore have a negative impact with regard to facilitating Applicable BSC Objective (c).

In respect of the comments made in sections 2.2.1 and 2.2.3 of the Assessment Consultation document regarding one Party (the Clearing House) receiving information about another Party which is not made available to other Parties, this gives the Clearing House a clear commercial advantage which we believe

runs counter to the intention of the Code. We believe that (if notified of a problem at a Party) far from helping the 'at-risk' Party, that a Clearing House would be under commercial pressure (from their internal Compliance/Risk functions) and possibly regulatory obligations (from the FSMA) to:-

- a) stop offering future trades with that Party; and
- b) seek to unwind existing trades with that Party.

The effect of this would inevitably be to 'drive' the 'at-risk' Party into a worse position than had that Party been left to resolve its position on its own (following notification from BSCCo). We believe that the commercial advantage afforded to a Clearing House by virtue of their being able to mitigate the risks over the credit-worthiness of counterparties would be detrimental to competition and would therefore have a negative impact with regard to facilitating Applicable BSC Objective (c).

In respect of the proposition to halve the Notified Volume Charges applied to Clearing Houses, we do not support this as it would be detrimental to competition and would therefore have a negative impact with regard to facilitating Applicable BSC Objective (c). In coming to this opinion we noted that:-

"as any cost-saving for Clearing Houses would be recovered via Parties' Main Funding Shares, P146 would effectively create a cross-subsidy for Clearing Houses...[and that] those Parties wishing to gain the benefit of using a Clearing House [should] cover the cost resulting from the additional notified volume, [and that this] is more appropriate than P146's proposal to recover the additional volume cost from all Parties....[and that] since they are not physical traders, Clearing Houses [already receive an advantage as they] do not pay Main Funding Shares."

Please note our response to any of the following questions should not be construed to lend support whatsoever to this Modification.

**Q2 Do you believe that an Alternative Modification consisting only of the new participation category and charging aspects of P146 (i.e. with the potential Credit Default warning provisions removed) would better facilitate the achievement of the Applicable BSC Objectives? Please give rationale and state objective(s).**

No.

**Q3 Which, if any, of the five qualification criteria options outlined in Section 2.1.2 do you believe should be applied to the new participation category of Clearing Houses? Are there any additional or alternative criteria that you believe should be considered? Please give rationale.**

We note the comments made in section 2.1 of the Assessment Consultation document regarding a new category of 'Clearing House'. Whilst we do not believe that this Modification Proposal will better facilitate the achievement of the Applicable BSC Objectives, of the five options outlined in section 2.1.4 we believe that Option 1 is the most suitable to apply.

We note the comments reported that some members of the Group did not support Options 1 or 2 since they set a precedent by including external legislation and regulation as a Code qualification criteria. We do not agree with these comments. The body that, in effect, sets the Code qualification criteria, as noted, is Ofgem by virtue of the granting of a licence. The power for Ofgem to do this comes directly from Parliament, as it does for the FSA. Therefore we believe

that as there is a competent body (the FSA) already established (on the same basis as Ofgem) to grant a 'licence' to Clearing Houses, that the electricity sector should use this body rather than set up a mirror body to 'certify' Clearing Houses (for BSC purposes).

**Q4 Do you agree with the view of the Proposer that P146 would result in increased use of Clearing Houses under the Code? Please give rationale.**

**Q5 Do you support the implementation approach described in the consultation document? Please give rationale.**

No. For the reasons outlined above.

**Q6 Do you believe there are any alternative solutions that the Modification Group has not identified and that should be considered? Please give rationale.**

None at this time.

**Q7 Does P146 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure? Please give rationale.**

Our comments are outlined in our answer to the questions above.

**Q8 Are there any further comments on P146 that you wish to make?**

Nothing further at this time.

Regards

Garth Graham  
Scottish and Southern Energy plc

**P146\_ASS\_006 – Scottish Power UK plc**

<b>Respondent:</b>	Man Kwong Liu (SAIC Ltd)
<b>No. of BSC Parties Represented</b>	6
<b>BSC Parties Represented</b>	<i>Please list all BSC Parties responding on behalf of (including the respondent company if relevant).</i> Scottish Power UK plc; ScottishPower Energy Management Ltd.; ScottishPower Generation Ltd; ScottishPower Energy Retail Ltd.;
<b>No. of Non BSC Parties Represented</b>	
<b>Non BSC Parties represented</b>	<i>Please list all non BSC Parties responding on behalf of (including the respondent company if relevant).</i>
<b>Role of Respondent</b>	<i>(Supplier/Generator/ Trader / Consolidator / Exemptable Generator / BSC Agent / Party Agent / other – please state)</i> Supplier / Generator / Trader / Consolidator / Exemptable Generator / Party Agent

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
1.	Do you believe that the Proposed Modification P146 better facilitates the achievement of the Applicable BSC Objectives? Please give rationale and state objective(s).	No	We do not believe P146 better facilitates the achievement of the Applicable BSC Objectives. The potential credit default provision would detriment the facilitation of the competition objective (c) as it would adversely impact a party's reputation, without the opportunity for them to resolve the situation as allow by the Code. The need for a Cure Period and the reputation of a party is of particular importance as indicated in the numbers of Mod proposals on credit default. We do not believe such provision in P146 would achieve any benefit.  The early notification of potential credit default to one market participant is discriminatory and would potentially give that Party the opportunity to take corrective action ahead of (and to the detriment of) other Parties. In addition, confidentiality of such information is also an issue.
2.	Do you believe that an Alternative Modification consisting only of the new participation category and charging aspects of P146 (i.e. with the potential Credit Default warning provisions removed) would better facilitate the achievement of the Applicable BSC Objectives?	Yes	We believe that without the potential Credit Default warning provisions, it would remove the concern of parties as indicated in Qu.1 above. However, we cannot see how reducing the notification charges help the liquidity of the market unless there is corresponding reduction in clearing costs to members. We believe that parties/members are already paying this charge and this service is the Clearing House's business.

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
	Please give rationale and state objective(s).		Nonetheless, due to the relative small charges involved, if there is a potential that the cost of such service could reduce, then the Alternative could better facilitate the competition objective (c).
3.	Which, if any, of the five qualification criteria options outlined in Section 2.1.2 do you believe should be applied to the new participation category of Clearing Houses? Are there any additional or alternative criteria that you believe should be considered? Please give rationale.	Option 1	Due to the privilege position of such category, we believe in the tightest criteria. We therefore agree that Option 1 would be the most appropriate and efficient, as it provides an existing means of reassurance and comfort in term of fitness for purpose, capital adequacy, market neutrality and commercial confidentiality to the parties. Other options either create far less efficient process and/or potentially open up to a large number of companies without the reassurance of Option1.
4.	Do you agree with the view of the Proposer that P146 would result in increased use of Clearing Houses under the Code? Please give rationale.	No	See our comments on Qu. 1 and 2 above.
5.	Do you support the implementation approach described in the consultation document? Please give rationale.	Yes	We agree the least cost and most effective option should be adopted.
6.	Do you believe there are any alternative solutions that the Modification Group has not identified and that should be considered? Please give rationale.	No	
7.	Does P146 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure? Please give rationale.	No	
8.	Are there any further comments on P146 that you wish to make?	No	

**P146\_ASS\_007 – EDF Trading Ltd**

<b>Respondent:</b>	<i>Steve Drummond</i>
<b>No. of BSC Parties Represented</b>	<i>Two</i>
<b>BSC Parties Represented</b>	<i>EDF Trading Ltd and EDF (Generation)</i>
<b>No. of Non BSC Parties Represented</b>	<i>None</i>
<b>Non BSC Parties represented</b>	<i>N/A</i>
<b>Role of Respondent</b>	<i>Trader and Generator respectively</i>

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
1.	Do you believe that the Proposed Modification P146 better facilitates the achievement of the Applicable BSC Objectives? Please give rationale and state objective(s).	No	As proposed with the inclusion of the Clearing House being in receipt of party default information prior to other market parties, then we believe it is difficult for the modification to better achieve the BSC Objectives.
2.	Do you believe that an Alternative Modification consisting only of the new participation category and charging aspects of P146 (i.e. with the potential Credit Default warning provisions removed) would better facilitate the achievement of the Applicable BSC Objectives? Please give rationale and state objective(s).	Yes	An Alternative Modification as described however would provide a greater likelihood of market participants using the Clearing House services and this approach would therefore be supportable. It would also part way correct the anomaly on charging CH trades as opposed to bilateral or PE trades and hence is less discriminatory.
3.	Which, if any, of the five qualification criteria options outlined in Section 2.1.2 do you believe should be applied to the new participation category of Clearing Houses? Are there any additional or alternative criteria that you believe should be considered? Please give rationale.	2	Option 1 is too selective and excludes parties who offer clearing services and Options 4 & 5 are not linked to the BSC. Therefore Options 2 or 3 should be explored. Our preference being for Option 2 if it goes forward.
4.	Do you agree with the view of the Proposer that P146 would result in increased use of Clearing Houses under the Code?	Yes	If there is a reduction in the charges to CH users then there is likely to be greater take-up of those services, especially as there appears to be a growing desire among traders to use cleared products to reduce their

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
	Please give rationale.		counter-party risk.
5.	Do you support the implementation approach described in the consultation document? Please give rationale.	Yes	
6.	Do you believe there are any alternative solutions that the Modification Group has not identified and that should be considered? Please give rationale.	No	
7.	Does P146 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure? Please give rationale.	No	Other than as mentioned below.
8.	Are there any further comments on P146 that you wish to make?	Yes	What impact will the takeover of UKPX by APX have on the proposal? There is also concern that, whilst it reduces CH costs and maybe reduces charges to CH users, it won't actually reduce system costs overall. Moreover the likely change costs might outweigh the benefits in the short term and so there is likely to be a net increase cost to parties. Perhaps a longer term assessment is required for the mod to be accepted.



**P146\_ASS\_008 – EDF Energy Networks (EPN) plc**

<b>Respondent:</b>	Paul Chesterman
<b>No. of BSC Parties Represented</b>	9
<b>BSC Parties Represented</b>	EDF Energy Networks (EPN) plc; EDF Energy Networks (LPN) plc EDF Energy Networks (SPN) plc; EDF Energy (Sutton Bridge Power) EDF Energy (Cottam Power) Ltd; EDF Energy (West Burton Power) Ltd; EDF Energy plc; London Energy plc; Seaboard Energy Limited
<b>No. of Non BSC Parties Represented</b>	
<b>Non BSC Parties represented</b>	
<b>Role of Respondent</b>	Supplier / Generator / Party Agent / Distribution Business

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
1.	Do you believe that the Proposed Modification P146 better facilitates the achievement of the Applicable BSC Objectives? Please give rationale and state objective(s).	No	As we support the increased use of Central Clearing as a means of mitigating almost all credit risk. However, as proposed with the inclusion of the Clearing House being in receipt of party default information prior to other market parties, then we believe it is difficult for the modification to better achieve the BSC Objectives.
2.	Do you believe that an Alternative Modification consisting only of the new participation category and charging aspects of P146 (i.e. with the potential Credit Default warning provisions removed) would better facilitate the achievement of the Applicable BSC Objectives? Please give rationale and state objective(s).	Yes	We feel that de-scoping the proposal in this manner would make it more supportable
3.	Which, if any, of the five qualification criteria options outlined in Section 2.1.2 do you believe should be applied to the new participation category of Clearing Houses? Are there any additional or alternative criteria that you believe should be considered?	2 or 3	We feel that Option 1 is restrictive and that Options 4 & 5 might not be desirable, since the broad requirements of the FSA are not linked to the BSC. Therefore Options 2 or 3 should be explored.

	<b>Question</b>	<b>Response</b>	<b>Rationale</b>
	Please give rationale.		
4.	Do you agree with the view of the Proposer that P146 would result in increased use of Clearing Houses under the Code? Please give rationale.	Yes	This would seem to follow. However we do not feel that the 'double Notification Fees issue' is significant in a Trading Party's decision to use a Clearing House.
5.	Do you support the implementation approach described in the consultation document? Please give rationale.	Yes	We would be confident that we have been well advised by Elexon.
6.	Do you believe there are any alternative solutions that the Modification Group has not identified and that should be considered? Please give rationale.	No	None that we are aware of, or that we would want to pursue at present
7.	Does P146 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure? Please give rationale.	No	
8.	Are there any further comments on P146 that you wish to make?	Yes	What impact will the takeover of UKPX by APX have on the proposal. Moreover the likely change costs might outweigh the benefits in the short term and so there is likely to be a net increase cost to parties.

**ANNEX 4 BSC AGENT IMPACT ASSESSMENT RESPONSE**

<b>NETA Change Form</b>		<b>ELEXON Reference</b>		
		MP146		
<b>Title</b>		<b>Version No.</b>		
P146 – New participation category to the BSC – Clearing House		Version 0.2		
		<b>LogicaCMG Reference</b>		
		ICR565		
<b>Type of Assessment</b>	<b>Date Received</b>	<b>Date IA Issued</b>		
Impact Assessment	22-Dec-2003	9-Jan-2004		
<b>Brief Summary of Change</b>				
<p>This Modification seeks to introduce a new category of 'Clearing House', which would be able to submit Energy Contract Volume Notifications (ECVNs) as currently, but would not be authorised to act in any other participation capacity.</p> <p>This assessment version 0.2 is against the BRS for P146, Version 1.0 dated 4<sup>th</sup> Dec 2003 and "P146AC10.doc" dated 18 December 2003. It thus takes clarification of Material Doubt issues into consideration.</p>				
<b>LogicaCMG's Proposed Solution</b>				
<p>As requested this response considers the System Changes and Process Changes separately.</p> <p>We have identified four valid combinations of System changes (Options 1-4) and as these are mutually exclusive we have priced each one separately. The two process changes are also treated as separate options and each priced (although they could both be ordered).</p>				
	Option 1	Option 2	Option 3	Option 4
Systems Software Change				
2.1.1.1 New Category Clearing Houses	X	X	X	X
2.1.2.1 Notification of Credit Defaults		X		X
2.1.3.1 Single Notified Volume Charge			X	X
	Option 5	Option 6		
Manual Process Change				
2.1.1.2 New Category Clearing Houses	X			
2.1.2.2 Notification of Credit Defaults		X		
2.1.3.2 Single Notified Volume Charge				

## System Changes

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The system changes required to implement P146 are summarised below under each BRS requirement (by BRS section number):

### 2.1.1.1 New Category of "Clearing House"

- A new Clearing House (CH) market role code will be added to the system.

### 2.1.2.1 Potential Credit Defaults to Clearing Houses

## **The procedures around the breaching of credit limits and the process of notifying BSCCo and Parties can be summarised as follows:**

Current Process:

- 1) A breach occurs and LogicaCMG Help Desk contacts BSCCo Duty Manager and informs them of the breach
- 2) After Query Period expires (24 Hours) LogicaCMG Help Desk contacts BSCCo Duty Manager and informs them of the current Credit Level.
- 3) At this time (or some time later) the BSCCo Duty Manager makes a decision about material doubt and if appropriate instructs the help desk to set the Credit Default Authorisation Flag (CDAF)

New Process required:

- 1) A breach occurs and LogicaCMG Help Desk contacts BSCCo Duty Manager and informs them of the breach. **They also inform the Duty Manager if any active authorisations exists with a Clearing House party.**
- 2) After Query Period expires (24 Hours) LogicaCMG Help Desk contacts BSCCo CVA Ops Duty Manager and informs them of the current Credit Level.
- 3) At the same time as step 2 above, the BSCCo Duty Manager makes a decision about material doubt and **if appropriate instructs the help desk to issue an e-mail to any Clearing Houses effected. This is the one and only chance to send CH parties e-mails.**
- 4) At the same time as step 3 (or some time later) the BSCCo Duty Manager makes a decision about material doubt and if appropriate instructs the help desk to set the Credit Default Authorisation Flag (CDAF). **This is in addition (and separate) to any instruction to send emails to the relevant Clearing Houses.**

Actions:

- The new role code will be applied to participants in the usual way in CRA and transferred to ECVAA in the existing registration flows.
- Changes to the Credit Check process:
- When an 80% breach is detected, identify all Clearing Houses that have current Authorisations with the defaulting party.
- Inform the BSCCo Duty Manager of these Clearing Houses at the same time as informing them of the breach
- At the end of the Query Period, the Help Desk inform the BSCCo Duty Manager of the current credit level. The Duty Manager makes a decision based on this level and whether material doubt exists and if appropriate instructs the help desk to send emails to the relevant clearing houses. **This is in addition (and separate) to any instruction to set the Credit Default Authorisation Flag (CDAF).**
- If instructed to send Clearing House e-mails the system will, for each Clearing House identified

- above, generate and send an email to the helpdesk where it will be sent on to the appropriate Clearing House.
- The LWIs will be extended to add the new email to those already generated in the Credit Default Process.
- New email template to be added to the system.

2.1.2.2 Potential Credit Defaults to Clearing Houses (process change)

- Although this option relates to the process change option, it should be noted that some system development will still be required. A script or Oracle Report will be required to allow operators to identify which Clearing Houses have authorisations with the defaulting party.

2.1.3.1 Single Notified Volume Charge for Clearing Houses

- Amend the ECVAA Section D report to halve the total energy volume for Clearing Houses.

**Process Changes**

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The process changes required to implement P146 are summarised below under each BRS requirement (by BRS section number):

2.1.1.2 New Category of "Clearing House"

- New process to maintain a list of clearing houses.

2.1.2.2 Potential Credit Defaults to Clearing Houses (process change)

- Current Credit Default Process will be extended to include the new requirements for clearing houses:
- New process to identify affected Clearing Houses using new script (see system changes)
- New manual process to generate new format e-mails and send to affected Clearing Houses. - Update LWI's in line with these new processes

2.1.3.2 Single notified Volume Charge (process change)

As noted in the BRS there is no central service impact of this process change.

**Deviation from ELEXON's Solution / Requirements**

**The manual option for notifying Clearing Houses of potential defaults is NOT the preferred option.** It is a complex manual process that will need to be implemented by out of hours helpdesk staff. There is therefore a serious risk of non-notification or miss-notification.

**Operational Solution and Impact**

None

**Testing Strategy**

Unit	X	Change Specific	X	End to End	
Module	X	Operational Acceptance	X	Participant Testing	
System	X	Performance		Parallel Running	
Regression		Volume		Deployment/ Backout	X

Other:							
<b>Validated Assumptions</b>							
<p>1) The system will not check that the new role code is only applied to BSC Parties. ELEXON will handle all issues of controlling registration restrictions (i.e. No BMU's, etc)</p> <p>2) <i>E-mails to clearing houses will only be sent if the BSCCo Duty manager so instructs the Help Desk at the time when the Help Desk contacts them to advise that the Query Period has ended and what the current level is (Therefore this is the one and only opportunity for these e-mails to be sent).</i></p> <p>3) <i>There are no changes to the procedures for supporting BSCCo's investigation of Material Doubt.</i></p> <p>4) <i>There are no changes to the current contact procedures for informing BSCCo of Credit breaches.</i></p> <p>5) <i>The trigger for sending e-mails to any Clearing Houses will be initiated by the BSCCo Duty Manager, and thus any decisions about percentage levels are made by the Duty manager.</i></p>							
<b>Outstanding Issues</b>							
<p>1) There is no requirement to notify any Clearing House when the Credit Default is cleared.</p> <p>2) The new e-mail will only contain a subset of the current e-mails information (i.e. no actual percentage level, no new information)</p>							
<b>Changes to Service</b>							
<b>Services Impacted</b>							
	BMRA	CDCA	CRA	ECVAA	SAA	TAA	Other
Software			X	X			
IDD Part 1 (Docs)				X			
IDD Part 1 (S'heet)							
IDD Part 2 (Docs)							
IDD Part 2 (S'heet)							
URS				X			
SS				X			
DS				X			
MSS			X				
OSM			X				
LWIs			X	X			
RTP	[ None ]						
Comms	[ None ]						
Other	[ None ]						
<b>Nature of Documentation Changes</b>							
<p>All documents identified are to be updated to bring into line with the chosen solution. The exact documents effected vary with the option selected.</p>							

<b>Nature / Size of System Changes</b>	
Small or Medium dependant on Option Selected	
<b>Type of Release Costed:</b>	Standalone Patch
<b>Deployment Issues, e.g. Outage Requirements:</b>	ECVAA outage may be required depending on which option is Ordered.
<b>Impact on Service Levels:</b>	None
<b>Impact on System Performance:</b>	May take longer for notification of potential credit default to ELEXON/Parties in the event of a breach (Especially Option 6)
<b>Responsibilities of ELEXON</b>	
<p>Within reasonable levels, ELEXON will make available appropriate staff to assist LogicaCMG during the development of this change.</p>	
<b>Acceptance Criteria</b>	
<p>Documentation:- Address of ELEXON review comments leading to final DCR issue being provided.</p> <p>Software:- This is covered by the acceptance criterion 2 in the "CVA Program – Release Acceptance Criteria" document for the Feb03 release.</p>	
<b>Any Other Information</b>	
None.	
<b>A.1.1 Attachments</b>	
MP146 Price Presentation V0.2 (Spread Sheet)	

<b>PRICING</b>		
<b>Price Breakdown</b>		
<b>Item description</b>	<b>Remarks</b>	<b>Price (ex VAT)</b>
Change Specific	Option 1 - Option 2 - Option 3 - Option 4 - Option 5 - Option 6 -	£ 25,209 £ 66,446 £ 51,288 £ 99,274 £ 6,544 £ 20,214
Variable Release Costs	Option 1 - Option 2 - Option 3 - Option 4 - Option 5 - Option 6 -	£ 0 £ 3,540 £ 3,540 £ 4,679 £ 0 £ 0
Fixed Release Cost	Option 1 - Option 2 - Option 3 - Option 4 - Option 5 - Option 6 -	£ 251,163 £ 264,562 £ 264,562 £ 279,405 £ 5,858 £ 251,163
<b>Total Price (ex VAT)</b>		Option 1 - £ 276,372 Option 2 - £ 334,548 Option 3 - £ 319,391 Option 4 - £ 383,357 Option 5 - £ 12,402 Option 6 - £ 274,917
<b>Price Tolerance</b>		<b>0 %</b>
<b>Project Duration</b>		Option 1 – 10 Weeks Option 2 - 12 Weeks Option 3 - 12 Weeks Option 4 – 14 Weeks Option 5 - 2 Weeks Option 6 - 10 Weeks
<b>Operational Price (e.g. per annum or event) (ex VAT)</b>		£ 0
<b>Rationale</b>		
N/A		
<b>Annual Maintenance Price (ex VAT)</b>		Option 1 - £ 3,529 Option 2 - £ 9,302 Option 3 - £ 7,180 Option 4 - £ 13,898 Option 5 - £ 0 Option 6 - £ 2,830
<b>Rationale</b>		
The Annual Maintenance Price is derived as 14% of the Change Specific Price.		



<b>Validity Constraints</b>	
<ul style="list-style-type: none"> <li>• Price excludes provision for indexation of daily rates from 1<sup>st</sup> April 2004.</li> <li>• Price and duration assume that this change is developed in isolation and the effects of other changes are excluded.</li> <li>• Price is for creating DCRs, not a formal documentation issue.</li> <li>• No allowance is included for supporting PwC activities. Any effort will be charged at contracted T&amp;M rates</li> <li>• No allowance is included for supporting ELEXON assurance activities. Any effort will be charged at contracted T&amp;M rates</li> <li>• No allowance is included for End to End/Participant Testing activities. Any effort will be charged at contracted T&amp;M rates</li> <li>• No allowance is included for Walkthrough activities. Any effort will be charged at contracted T&amp;M rates</li> </ul> <p>The validity period for this quote is 30 days and the offer is based on the following payment schedule:</p> <p>If a software change is ordered then</p> <ul style="list-style-type: none"> <li>• LogicaCMG will invoice 30% on receipt of Purchase Order or authorised start of work, 30% on completion of first build phase, 30% on live implementation and 10% on successful completion of the Success Criteria or one month after live implementation, whichever is sooner.</li> </ul> <p>Or if the documentation only change is ordered then</p> <ul style="list-style-type: none"> <li>• LogicaCMG will invoice in full for this change on deployment or within one month of the change being ready for deployment</li> <li>• Maintain charges will be invoiced monthly in arrears with part months charged pro rata</li> </ul>	
<b>Authorised Signature</b>	<b>Date Signed</b>

## ANNEX 5 PARTY, PARTY AGENT AND CORE INDUSTRY DOCUMENT OWNER IMPACT ASSESSMENT RESPONSES

### Responses received to MC00078: Detailed Level Impact Assessment of P146

Organisation	Comments
Clare Talbot NGC	No impact identified.
Deborah Hayward Aquila Networks	No comment.

## ANNEX 6 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. In order to give Stakeholders a feel for the estimated cost of implementing an Approved Modification the templates shown in Section 2 have 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:

SERVICE PROVIDER <sup>13</sup> COSTS	
<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

<sup>13</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.

	various other standard release activities.
<b>Incremental Release Cost</b>	The Release Cost detailed above assumes a limit to the number and complexity of changes in the scope of the release. If this limit is breached by the inclusion of a Modification Proposal, then that Modification Proposal may necessitate additional project management, testing, or other standard release activities and so may incur additional Release Costs.

### IMPLEMENTATION COSTS

<b>External Audit</b>	Allowance for the cost of external audit of the delivery of the release. For CVA BSC Systems Releases this is typically estimated as 8% 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.
<b>Design Clarifications</b>	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%.
<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>	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.

### 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

<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.