

## MODIFICATION REPORT for Modification Proposal P142 Minor refinement to allow a Level 2 Default Cure period in defined circumstances

Prepared by: ELEXON on behalf of the BSC Panel

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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 Balancing and Settlement Code Panel recommends that:

- **Proposed Modification P142 should be made;**
- **The Implementation Date should be 3 November 2004, if an Authority determination is received before or on 23 March 2004, or 23 February 2005 if Authority determination is received after that date but before or on 13 July 2004; and**
- **The development and implementation costs for Proposed Modification P142 of £442,609 and ELEXON effort of 138 man days, subject to a 30% tolerance, be noted.**

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

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### SUMMARY OF IMPACTED PARTIES AND DOCUMENTS

The following parties/documents have been identified as being potentially impacted by Modification Proposal P142.

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

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

<b>Estimated cost of Progressing P142 through Modification Procedures</b>	<b>53 ELEXON man days</b>
<b>Cost of implementing Proposed Modification:</b>	
Change specific	£62,379
Standalone Release Cost	£252,933
BSC Auditor Effort	£31,531
Clarification of Solution	£15,766
Additional ELEXON Release Costs	£80,000
<b>Total:</b>	<b>£ 442,609 + 138 ELEXON man days</b>
<b>Cost of Operation/maintenance</b>	<b>£44,521 pa</b>

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

## 1.1 Modification Proposal

Modification Proposal P142 "Minor refinement to allow a Level 2 Default Cure period in defined circumstances" ('P142') was raised by Total Gas & Power Ltd on 29 August 2003 (reference 1).

The Panel considered the Initial Written Assessment for P142 at its meeting of 11 September 2003. The Panel submitted the P142 to a three month Assessment Procedure, with the assessment undertaken by the Settlement Standing Modification Group (SSMG).

P142 proposes that where a Trading Party's Credit Cover Percentage (CCP) exceeds 90% but remains below 100% outside normal business hours then a Level 2 Credit Default Cure Period shall exist, and shall last until two hours into the next Business Day. Prior to the expiry of the Level 2 Credit Default Cure Period, the Trading Party shall not be considered to be in Credit Default and the Credit Default Refusal and Rejection Periods shall not commence.

The purpose of the Level 2 Credit Default Cure Period is to allow the Trading Party the opportunity to lodge additional Credit Cover during banking hours.

The Proposer contends that, due to restrictions on banking hours, it is currently not feasible for a Party to resolve a Level 2 Credit Default outside business hours by lodging additional Credit Cover. The Proposer further suggests that a lack of sufficient liquidity on the traded power exchanges at such times may reduce the opportunities available to the Party to trade out of Credit Default.

It is argued that this combination of restrictions may mean that a Party who breaches 90% CCP over a weekend or Public Holiday period may not be able to extricate themselves from this circumstance, even if they are financially sound and wish to resolve the breach. A consequence of this is that they may be exposed to significant imbalance charges should a Credit Default Rejection or Refusal Period commence. The consequences of a Credit Default Rejection Period or a Credit Default Refusal Period are prescribed in Section M3.3 of the Balancing and Settlement Code ('the Code'), but may be briefly summarised as a restriction on the ability of the Party to lodge new Volume Notifications that do not decrease CCP in the case of the former, and an ongoing rejection of components of existing Volume Notifications that do not decrease CCP in the case of the latter.

It is contended that the intention of Credit Default procedures, to provide protection for the market against exposure to the unpaid Trading Charges of a Party in genuine financial difficulties, needs to be pragmatically balanced against the ability of a financially sound BSC Party to resolve Credit Default circumstances without being exposed to significant imbalance charges. The Proposer suggested that P142 better achieves this balance and therefore better facilitates Applicable BSC Objectives (c) and (d).

During the Assessment Procedure for P142, the SSMG met three times, on 17 September 2003, 21 October 2003 and 18 November 2003. The SSMG undertook one consultation and sought an impact assessment of P142 from Parties, BSC Agents, BSCCo and the Transmission Company.

The Panel considered the Assessment Report and the SSMG recommendations in respect of P142 at its meeting of 11 December 2003. The Panel agreed a provisional recommendation that P142 should not be made.

A draft Modification Report, containing the Panel's provisional recommendation, was issued for industry consultation on 19 December 2003. Nine responses, representing forty seven Parties, were received. The responses received are attached as Annex 3 of this report, and a summary of those responses is provided in section 5 of this report.

The Panel considered the draft Modification, including the consultation responses received, at its 15 January 2004 meeting. At that meeting, the Panel, by a majority, decided to recommend that the Proposed Modification should be made (see section 2.2 of this report for the rationale for that recommendation).

## 1.2 Proposed Modification

The SSMG agreed that a Party would be deemed to have made payment within the Level 2 Credit Default Cure Period if the FAA were to have confirmed receipt of the additional Credit Cover within the two hour window. In addition, the FAA and ECVAA would have a further period within which to action the revised ECC for the Party.

The FAA and ECVAA would have one hour from the time at which the FAA has confirmed receipt of additional Credit Cover from the Party in which to ensure that the ECVAA record of ECC is updated (i.e. the 'BSC Agent processing window').

In response to legal advice, the BSC Agent processing window has been included within the Level 2 Credit Default Cure Period rather than as a separate provision commencing upon its expiry. This has been achieved by prescribing that the Level 2 Credit Default Cure Period be considered to expire at 12:00 hours on the relevant day, with an obligation on the FAA to update the ECVAA regarding receipt of funds by this time if payment has been received by 11:00 hours. Applying the Level 2 Credit Default Cure Period in this way was considered to lead to a simpler legal baseline than two separate windows, whilst simplifying the timings of the authorisation notice needed to give effect to Level 2 Credit Default.

The ECVAA put forward two solutions for P142 which are detailed in more depth in the Assessment Report for Modification Proposal P142 (P142AR, reference 6).

The first of these (referred to as the 'Original Solution') was based around an automated solution that parameterised the Level 2 Credit Default Cure Period into ECVAA software.

The second ('Alternative Solution') was based around a semi-manual workaround that reduced ECVAA software changes to the issuing of a new data flow upon 100% CCP breaches and did not parameterise the Level 2 Credit Default Cure Period. The BSCCo would synthetically create the Level 2 Credit Default Cure Period by timing the issuing of authorisation notices such that ECVAA did not inadvertently put the qualifying Party into Credit Default.

The change specific costs attributed to these two solutions were £117,841 and £51,579 respectively in ECVAA costs. In addition, the Alternative Solution would incur a further £8,800 in BSCCo change specific costs.

The SSMG agreed that the Alternative Solution should be used as this would reduce costs. The Group believed that Level 2 Credit Default Cure Periods would be triggered sufficiently infrequently that system robustness would not be comprised by adoption of a semi-manual workaround.

## 1.3 Issues raised by the Proposed Modification

The following issues were considered during the Assessment of P142:

- Principles of Credit Cover and the Energy Indebtedness calculation;
- Level 1 Credit Default;
- Level 2 Credit Default;
- Interaction between Level 1 and Level 2 Credit Default;
- Definition of Business Hours;

- Credit Cover Percentage Thresholds;
- Use of the Query Period to address 90% Credit Cover Percentage breaches;
- Frequency of incidents;
- BSC Agent processing window;
- The Terms of Reference (see Annex 7 of the Assessment Report for details); and
- Possible implementation solutions.

A Requirements Specification (reference 3) was issued to the industry on 3 October 2003 seeking impact assessments from the BSC Agents, BSC Parties, BSCCo and Transmission Company. A Consultation Document (reference 5) was issued on 3 November 2003 seeking comment on the principles and issues raised by P142 from BSC Parties and the Transmission Company.

The SSMG deliberations on these issues are detailed within the Assessment Report for Modification Proposal P142 (P142AR, reference 6). Therefore the issues are not detailed further in this Modification Report.

#### **1.4 Assessment of the Proposed Modification in respect of the Applicable BSC Objectives**

The Modification Group agreed that P142 did not dilute the deterrent effect of Level 2 Credit Default as the treatment of 100% CCP breaches would remain unchanged, Parties would therefore still be incentivised to reduce high levels of CCP to avoid the risk of Volume Notification refusal or rejection. Additionally, P142 provides that where a Level 2 Credit Default Cure Period lapsed without the Party taking action to reduce their CCP below 90% that they should be considered to be in Level 2 Credit Default with a Credit Default Rejection and Refusal Period triggered. The SSMG therefore agreed that the market would not be unnecessarily exposed to risk by P142.

The SSMG considered that P142 would facilitate competition in the market as it may reduce incentives for the over-provision of Credit Cover. P142 seeks to avoid the circumstance whereby a Party may enter authorised Level 2 Credit Default with a CCP of under 100%, without having had an opportunity to lodge additional Credit Cover. Parties may be providing excessive levels of Credit Cover in order to avoid the risk of this occurrence. P142 may provide assurance that will allow Parties to lodge Credit Cover at more realistic levels.

The easing of such incentivisation towards over-provision of Credit Cover may also remove a barrier to entry to the market by reducing the collateral needed by a new market entrant.

Additionally, the Modification Group considered that P142 may ameliorate perverse incentives on trading behaviour resulting from Level 2 Credit Default. It was considered that under the current baseline, where no Level 2 Credit Default Cure Period exists for Level 2 Credit Default, a Party breaching 90% outside business hours may be left with no alternative but to trade out of their position. This may result in the Party adopting a non-optimal trading position purely to manage their CCP. The Modification Group considered that this would be unfair on a Party whose CCP remained below 100% as they would be constricted in their ability to trade freely despite having Credit Cover in excess of their estimated outstanding Trading Charges.

The Modification Group further noted that the lack of an alternative to the Party beyond trading out of their position may impact upon System Buy and Sell Price (SBP/SSP) volatility as they may engage in trades with the Market Index Data Providers (MIDPs) with little flexibility on whether to accept energy prices quoted.

For the above reasons, the Modification Group concluded that P142 would better facilitate Applicable BSC Objective (c) – ‘Promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity’.

### **1.5 Modification Group’s cost benefit analysis of Proposed Modification**

The development of P142 could incur costs of approximately £442,609. This encompasses BSC Central Service Agent development and implementation costs of £62,379, plus (standalone) release costs of £252,933. The following costs additional BSCCo costs would also be incurred during development:

- £31,531 (10% of the total BSC Agent cost for the BSC Auditor effort);
- £15,766 (5% of the total BSC Agent cost for any clarification to the solution during development); and
- £80,000 (fixed price for a BSCCo Release).

This excludes BSCCo effort of approximately 138 man days. There is an additional +/- 30% tolerance on the overall cost reflecting contingency against actual implementation resourcing deviating from that expected.

In addition to development costs, there would be an annual maintenance cost for Proposed Modification P142 of £44,251 p.a.

A lead time of approximately 32 weeks is required.

Therefore, provisional discussions indicate that:

- P142 is to be delivered in the November 2004 (3 November 2004 Implementation Date) BSC Systems release, if an Authority determination is received on or by 23 March 2004; and
- P142 is to be delivered in the February 2005 (23 February 2005 Implementation Date) BSC Systems release, if an Authority determination is received after 23 March 2004, but on or by 13 July 2004.

Details of the benefits associated with the implementation of P142 are provided in section 1.4 above.

### **1.6 Alternative Modification**

Neither the SSMG, nor any of the respondents to the Consultation Document, identified any Alternative Modifications that would, in their opinion, better address the perceived defect.

### **1.7 Governance and Regulatory Framework Assessment**

Neither the SSMG, nor any of the respondents to the Consultation Document, identified any impact upon the Governance and Regulatory Framework.

## **2 RATIONALE FOR PANEL’S RECOMMENDATIONS**

The Panel noted the SSMG’s recommendations on P142 at its 11 December 2003 meeting, but, on the basis of the arguments presented, agreed a provisional recommendation that the Proposed Modification should not be made. However, on the basis of the refinement of the arguments in favour of P142 made by respondents to the consultation on the draft Modification Report and clarification of the implementation costs were P142 implemented as part of a batched release provide by ELEXON, the Panel agreed a final recommendation that P142 should be made.

The conclusions of the SSMG and the Panel are detailed in the sub-sections below.

## 2.1 SSMG recommendations to Panel

The SSMG concluded that:

- P142 would not dilute the deterrent effect of Level 2 Credit Default or expose the market to unnecessary risk.
- P142 would facilitate more effective competition by:
  - reducing incentives for the over-provision of Credit Cover and therefore reduce the opportunity cost of excessive collateral being lodged for this purpose. This would not only benefit existing Parties but also potentially reduce barriers to entry through a decrease in the amount of collateral required for Credit Cover for new Parties; and
  - removing perverse incentives upon a Party whose Credit Cover exceeds their estimated Trading Charges, but who has breached 90% CCP outside business hours, to potentially submit commercially undesirable Volume Notifications purely to reduce their CCP; and
  - reducing the necessity of a Party breaching 90% CCP to trade out of this position in defined circumstances. This may reduce the likelihood of trades to avert Credit Default being entered into with Market Index Data Providers, and therefore increase the likelihood that the Energy Imbalance Price calculated from Market Index Data (MID) is representative of short-term prices for energy ahead of Gate Closure in the forwards and spot markets.

For these reasons, the SSMG concludes that P142 would better facilitate Applicable BSC Objective (c) – ‘Promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity’.

The Modification Group acknowledged that the BSCCo had received legal advice stating that Applicable BSC Objective (d) – ‘Promoting efficiency in the implementation and administration of the balancing and settlement arrangements’ - is concerned with central BSCCo costs incurred in implementing and administering the Code. As no BSCCo cost savings were identified during the Assessment Procedure, P142 was not considered to better facilitate achievement of Applicable BSC Objective (d).

## 2.2 Panel recommendations

The Panel considered the P142 Assessment Report at its 11 December 2003 meeting.

The Panel noted that both the Modification Group and the respondents to the Consultation Document had visibility on the proposed implementation and operational maintenance costs of P142 during the Assessment Procedure, but the Panel did not agree with the conclusions reached regarding the desirability of approval.

The Panel considered that the short duration of the Level 2 Credit Default Cure Period restricted its usefulness, as smaller Parties might not be in a position to lodge additional Credit Cover in time even if they were to qualify for a Level 2 Credit Default Cure Period.

The Panel further believed that the benefits of P142 would accrue to an affected Party, rather than the industry as a whole. The Panel was unconvinced such costs should be borne by the wider BSC community.

The Panel noted that P142 scenario incidents have been extremely rare historically. The Panel therefore believed that costs incurred to implement P142 were likely to be significant in relation to any benefit.

As a consequence, the Panel concluded that costs related to the implementation and operation of P142 would outweigh any benefits. The Panel therefore considered that the negative impact of P142 on Applicable BSC Objective (d) – ‘Promoting efficiency in the implementation and administration of the balancing and settlement arrangements’ - exceeded any positive impact it might have on Applicable BSC Objective (c) - ‘Promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity’.

The Panel therefore made a provisional recommendation that Proposed Modification P142 should **not** be made. This recommendation was consulted as part of the draft Modification Report issued to the Industry in December 2003.

On the basis of the refinement of the arguments in favour of P142 made by respondents to the consultation and clarification of the implementation costs were P142 to be implemented as part of a batched release, the Panel, by a majority of 6 to 1 (with one abstention), agreed a **final recommendation that P142 should be made**.

The majority of Panel members considered that implementation of P142 would better facilitate achievement of Applicable BSC Objective (c) because it would provide financially sound Parties with a practical opportunity to avoid entering into Level 2 Credit Default, without exposing other market participants to additional risk. The 100% CCP safety ceiling, whereby any Party whose projected liabilities exceed its Credit Cover (i.e. a breach of 100% CCP) is immediately entered into Level 2 Credit Default, would avoid exposing the market to any additional risk. In addition, the Panel noted the argument presented that P142 would act as an incentive to reduce the provision of Credit Cover. One Panel member quoted an estimated saving of £150,000, provided in a consultation response, which would be realised were P142 implemented.

The Panel also noted ELEXON's estimate that implementing P142 as part of a batched release, the basis upon which the proposed Implementation Dates were set, would reduce the implementation cost to approximately £150,000. As a consequence, the majority of Panel members were of the opinion that the negative impact of P142 on Applicable BSC Objectives (d) (i.e. the central costs incurred through implementation and administration of the proposal) would be reduced and outweighed by the positive impact on Applicable BSC Objective (c).

In the event that an Authority determination to approve P142 is received before or on 23 March 2004, the Panel recommends an Implementation Date of 3 November 2004. Should an Authority determination to approve be received after 23 March 2004 but before or on 13 July 2004, the Panel recommends an Implementation Date of 23 February 2005.

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

#### **3.1 BSCCo**

The following impacts upon BSCCo systems have been identified:

##### **3.1.1 Resourcing for helpdesk calls**

P142 would increase the complexity of Section M provisions. BSCCo Service Delivery may see an increase in both the number of helpdesk calls relating to the application of Credit processes and in the time spent addressing these calls.

### 3.1.2 Need to monitor 100% CCP breaches

Under the current BSC baseline, BSCCo issues authorisation notices upon the expiry of the Query Period except where material doubt exists. This means BSCCo can precisely forecast when an authorisation notice should be issued.

The proposed solution will require BSCCo to delay issuing an authorisation notice where a Level 2 Credit Default Cure Period exists in order to avoid inadvertently triggering the Credit Default Refusal and Rejection Periods parameterised within ECVA. The Level 2 Credit Default Cure Period could end at any time should the Party breach 100% CCP.

BSCCo will need to have robust working practices in place to ensure authorisation notices can be issued instantaneously when this happens.

### 3.1.3 Local Working Instructions

Local Working Instructions ('LWIs') relating to Credit Cover and Credit Default processes will need to be modified.

### 3.1.4 Implementation effort

Internal Impact Assessments within BSCCo have suggested that a total of 138 man days' effort plus £8,800 in change specific costs would be required to implement P142.

This is broken down as follows:

- 126 man days for CVA Programme activity. 100 of these relate to software testing activity applicable to a low complexity release and may be reduced by the presence of other Modifications or Change Proposals that require software changes within the same release. The remaining 26 days is for implementing changes to: the ECVA User Requirement Specification; ECVA System Specification; ECVA Design Specification; ECVA Service Description; ECVA Operational Services Manual; Interface Definition Document (IDD) Part 1; IDD Part 2; Business Process Model; and FAA Service Description;
- 12 man days for Assurance activity, for providing required support services to the CVA Programme; and
- £8,800 in change specific costs for Service Delivery, for putting in place LWI changes, training, development of operational service and IT requirements (laptops plus ISDN lines) for out-of-hours duty managers to manage new processes. Service Delivery additionally estimates an annual maintenance cost of between £16,200 and £33,400 dependent on the degree of out of Business Hours management of Credit Defaults required in practice.

## 3.2 BSC Systems

System / Process	Potential Impact of Proposed Modification
Credit Checking Systems	<p><b>New dataflow identifying 100% CCP breaches</b></p> <p>ECVA software will be changed such that a new flow will be sent to the BSCCo where a Party's CCP breaches the 100% CCP threshold. Operating procedures will need to be modified such that the ECVA also telephones BSCCo to inform them this flow has been sent.</p>
Clearing, Invoicing and Payment	<p><b>Provision of Credit Cover</b></p> <p>Where a Party qualifies for a Level 2 Credit Default Cure Period and the</p>

System / Process	Potential Impact of Proposed Modification
	FAA receives additional Credit Cover from that Party prior to 11:00 am on the next Business Day, they would have to calculate the Party's Energy Credit Cover and update the ECVAA with this information within one hour. Processing timescales for other transactions would be unaffected.

### 3.3 Parties and Party Agents

Six responses were received from Parties in response to the Requirements Specification, five of which indicated that P142 would have no impact in terms of costs, changes or implementation timescales.

The remaining response identified the following impacts:

- Requirement for minor changes to processes to recognise additional time available to post funds to resolve Credit Default;
- Implementation timescale of one week; and
- Minimal implementation costs.

## 4 IMPACT ON CODE AND DOCUMENTATION

### 4.1 Balancing and Settlement Code

Section M 'Credit Cover and Credit Default' would be modified to reflect the parameters of the new Level 2 Credit Default Cure Period.

Annex X-1 'General Glossary' would be amended to reflect new definitions of Business Hours and Level 2 Default Cure Period.

The draft legal text is contained within an attached document.

### 4.2 Code Subsidiary Documents

The following Code Subsidiary documents would need to be modified to reflect the changed BSC Systems and Processes detailed above:

- ECVAA Service Description;
- ECVAA System Specification; and
- FAA Service Description.

### 4.3 Configurable items

The following configurable items would need to be modified to reflect the changed BSC Systems and Processes detailed above:

- ECVAA User Requirements Specification;
- ECVAA Manual System Specification;
- ECVAA Design Specification;
- ECVAA Operational Services Manual;
- Interface Definition Document Part 1;

- Interface Definition Document Part 2; and
- Business Process Model.

#### 4.4 BSCCo Memorandum and Articles of Association

No changes to the BSCCo Memorandum and Articles of Association have been identified as arising as a consequence of the Proposed Modification.

#### 4.5 Impact on Core Industry Documents and supporting arrangements

No changes to Core Industry Documents or supporting arrangements have been identified as arising as a consequence of the Proposed Modification.

### 5 SUMMARY OF CONSULTATIONS

A draft Modification Report, containing the Panel's provisional recommendation that P142 should not be made, was issued for industry consultation on 19 December 2003, with responses due back on 6 January 2004. Nine responses (47 Parties) were received. For reference, all responses received are attached as Annex 3 to this report.

The following sub-sections provide a summary of the responses received and document the Panel's views on those responses.

#### 5.1 Summary of the consultation responses

Question	Agree	Disagree	No Comment
Do you agree with the Panel's views on P142 and the provisional recommendation to the Authority contained in the draft Modification Report that P142 should not be made? <i>Please give rationale.</i>	3	5	1
Do you agree that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? <i>Please give rationale.</i>	6	0	3
Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P142? <i>Please give rationale.</i>	8	0	1
Do you believe there are any additional benefits to P142 that were not identified during the Assessment Procedure?	2	5	2
Are there any further comments on P142 that you wish to make?	1	6	2

##### 5.1.1 Panel's Provisional Recommendation

Three of the nine responses (20 Parties) supported the Panel's provisional recommendation that P142 should not be made. The reasons provided by those respondents for supporting the recommendation were as follows:

- the purported benefits of P142 would be outweighed by the costs of implementation and administration of the new arrangements;
- questionable that the provisions of P142 would have been beneficial in previous events of Credit Default;
- P142 would extend the risk that the market is exposed to unsecured liabilities for two hours into the next business day, and
- P142 would provide a disincentive for Parties to actively manage their credit cover positions.

Five of the nine responses (26 Parties) did not support the Panel's provisional recommendation that P142 should not be made. The reasons provided by those respondents for not supporting the recommendation were as follows:

- P142 would provide a pragmatic balance between protecting the market from the risk of unsecured liabilities<sup>2</sup> and providing financially sound Parties with the practical opportunity to resolve potential Level 2 Credit Defaults without exposure to imbalance charges;
- the benefits of P142 would outweigh the costs and the implementation cost quoted in the Assessment Report would decrease were the necessary changes made as part of a batched system release;
- under the current arrangements, the only option available to Parties in potential Credit Default outside business hours is to attempt to trade out of the position – which may be neither desirable nor feasible;
- under the current arrangements, financially sound Parties could be mistakenly perceived as a bad credit risk by counter-parties (which could result in those counter-parties stopping trading with such Parties); and
- the current arrangements incentivise Parties to provide excessive Credit Cover for fear of the consequences of Level 2 Credit Default and as a result of the inability to post additional Credit Cover outside business hours, implementing P142 would remedy this situation and as such a net benefit would be realised.

The final respondent, representing one Party, made no comment on the Panel's provisional recommendation.

### **5.1.2 Legal Text**

None of the responses received raised any issues or objections regarding the draft legal text attached to the draft report.

### **5.1.3 Implementation Date**

None of the responses received raised any issues or objections regarding the proposed Implementation Date contained in the draft report.

### **5.1.4 Further Comments**

Two respondents indicated that there were additional benefits to P142 that were not identified during the Assessment Procedure. The additional benefits cited were as follows:

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<sup>2</sup> One respondent indicated that, in their opinion, P142 would not expose the market to any additional risk arising from unsecured liabilities.

- P142 would reduce the current incentive to provide excessive Credit Cover due to greater opportunity to resolve potential Level 2 Credit Defaults. This respondent who made this point, estimated that implementation of P142 could offer the industry direct cost savings of £150,000 a year, based on a 5% reduction in the £200m 'excess' Credit Cover posted<sup>3</sup>, and further, potentially more significant, benefits in terms the opportunity cost represented by that over-provision of credit; and
- P142 would introduce the intangible, but significant, benefit of providing a mechanism whereby financially sound parties can avoid the consequences of being cited as being in Credit Default on the BMRS.

## 5.2 Comments and views of the Panel

The Panel noted the consultation responses, in particular three further refinements to the arguments in favour of the implementation of P142. First, the quantification of the argument that the current incentive to post 'excessive' Credit Cover would be reduced provided by one respondent. Second, the observation that the implementation cost of P142 would reduce were it implemented as part of a batched set of system releases. Third, that the market would not be exposed to any additional risk because of the 100% Credit Cover Percentage (CCP) safety ceiling – i.e. any Party breaching 100% CCP, at which point the credit cover in place would no longer match the projected liabilities of that Party, would immediately be entered into Level 2 Credit Default.

## 6 SUMMARY OF TRANSMISSION COMPANY ANALYSIS

### 6.1 Analysis

No impact has been identified resulting from this Modification Proposal 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 P142 better facilitates the Applicable BSC Objectives.

The Transmission Company did not believe that P142 would impact the computer systems and processes of the Transmission Company, have any implementation costs for them or require any consequential changes to Core Industry Documents.

The Transmission Company had no further comments.

### 6.2 Comments and views of the Panel

The Panel had no comments on the Transmission Company analysis.

## 7 DOCUMENT CONTROL

### 7.1 Authorities

Version	Date	Author	Reviewer	Change Reference
0.1	15/12/03	Richard Hall	Sarah Parsons	Change Delivery Review
0.2	19/12/03	Richard Hall	BSC Parties	Industry Consultation
0.3	07/01/04	Roger Salomone	Sarah Parsons	Change Delivery Review
0.4	09/01/04	Roger Salomone	n/a	For Panel Decision

<sup>3</sup> The £200m figure is based on the £230m quoted in a consultation document issued as part of the review of the Credit Assessment Price carried out by a BSC Panel sub-group in July 2003 (Reference 7). This figure represented the average daily over-collateralisation in the first half of 2003.

0.5	20/01/04	Roger Salomone	Sarah Parsons	Change Delivery Review
1.0	21/01/04	Roger Salomone	n/a	For Authority Decision

## 7.2 References

Ref	Document	Owner	Issue date	Version
1	Modification Proposal P142	ELEXON	29/08/03	1.0
2	P142 Initial Written Assessment (IWA P142)	ELEXON	05/09/03	1.0
3	Requirement Specification for Modification Proposal P142 'Revised Credit Cover methodology for Interconnector BM Units'	SSMG	03/10/03	1.0
4	Communications Requirement Document	ELEXON	24/06/03	7.0
5	Modification Proposal P142 Consultation Document (P142AC10)	SSMG	03/11/03	1.0
6	Assessment Report for Modification Proposal P142 (P142AR)	SSMG	05/12/03	1.0
7	Options for Review of the Credit Assessment Price (66_016c)	ELEXON	11/07/03	1.1

**ANNEX 1 LEGAL TEXT**

See separate attachment for legal text.

**ANNEX 2 MODIFICATION GROUP DETAILS**

<b>NAME</b>	<b>POSITION</b>	<b>MEMBER</b>
Roger Salomone	Chairman	Y
Richard Hall	Lead Analyst	Y
Steve Drummond	EdF Trading Ltd	Y
Mark Manley	British Gas Trading	Y
Paul Jones	Powergen	Y
Mark Pearce	National Grid Company	Y
Sharif Islam	Total Gas & Power Ltd	Y
Rob Barnett	Campbell Carr	Y
Joanne Ellis	Cornwall Consulting Ltd	Y
Jerome Williams	Ofgem	N
Steve Mackay	Ofgem	N
Sanjukta Round	Cornwall Consulting Ltd	N
Neil Smith	Powergen	N

**ANNEX 3 CONSULTATION RESPONSES**

See separate attachment for consultation responses.