

## Draft MODIFICATION REPORT for Modification Proposal P123 Assessment of Credit Cover following a change in a Party's Portfolio

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Consultation

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### RECOMMENDATIONS

On the basis of the analysis, consultation and assessment undertaken in respect of this Modification Proposal during the Assessment Procedure, and the resultant findings of this report, the Balancing and Settlement Code Panel provisionally recommends that:

- **Proposed Modification P123 should be made;**
- **The P123 Implementation Date should be 27 February 2004 (for the Spring 2004 BSC Season), should the Authority determination be received on or before 17 November 2003. Should an Authority determination be received after this date, but prior to 12 January 2004 then the Implementation Date should be 31 May 2004 (for the Summer 2004 BSC Season)**

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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/bscresl\\_docs/bsc\\_code.html](http://www.elexon.co.uk/ta/bscresl_docs/bsc_code.html)

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## II DOCUMENT CONTROL

### a Authorities

Version	Date	Author	Signature	Change Reference
0.1	10/07/03	Mandi Francis		
0.2	17/07/03	Change Delivery		

### b Distribution

Name	Organisation
Each BSC Party	Various
Each BSC Agent	Various
The Gas and Electricity Markets Authority	Ofgem
Each BSC Panel Member	Various
Energywatch	Energywatch
Core Industry Document Owners	Various

### c Related Documents

Reference	Document
Reference 1	Modification Proposal P123 'Assessment of Credit Cover following a change to a Party's Portfolio' Assessment Report (P123AR10, 4 July 2003)

## **1 SUMMARY AND RECOMMENDATIONS**

### **1.1 Recommendation**

Provided on the front cover of this Modification Report.

### **1.2 Background**

The Assessment Report for Modification Proposal P123 (Reference 1) contains the detailed background and history of Modification Proposal P123, and this report can be found on the BSC Website, as follows:

<ftp://www.elexon.co.uk/ta/modifications/modsprops/P123/P123AR10.pdf>

Modification Proposal P123 'Assessment of Credit Cover following a change in a Party's Portfolio' (P123) was raised by BizzEnergy Limited on 26 March 2003. P123 seeks to introduce the ability for Lead Party's to be able to reduce the magnitude of Demand Capacity for any Supplier Base and Additional BM Units for periods during a BSC Year where demand differs as a consequence of portfolio change (loss of customers), for example contracting rounds in April and October.

Furthermore, P123 seeks to amend the process whereby material doubt is applied to credit default situations, to attempt to shorten the length of time between the Credit Default notices being issued by the Energy Contract Volume Aggregation Agent (ECVAA) and being either Authorised or cancelled by BSCCo, (cancelled by the application of material doubt), in order to provide BSC Parties with more certainty around the application of material doubt by BSCCo. In order to achieve this, the Panel will be obliged to establish and maintain a material doubt guideline that BSCCo will use when determining and applying material doubt.

The BSC Panel (the Panel), considered the Initial Written Assessment for P123 at their meeting of 10 April 2003, and agreed to submit Modification Proposal P123 to the Assessment Procedure, with the Assessment Report to be submitted for consideration at the Panel meeting of 10 July 2003. The Panel also agreed that the Assessment Procedure should be undertaken by the Settlement Standing Modification Group (SSMG).

At its meeting of 10 April 2003, the Panel also considered the Initial Written Assessment for Modification Proposal P122 'Assessment of Credit Cover during Holiday Periods' (P122), also raised by BizzEnergy Limited on 26 March 2003. The Panel noted the similarity of the issues that Modification Proposals P123 and P122 seek to address, but agreed that the Modifications are different enough and thus should be assessed as separate Modification Proposals. The Assessment Report for P122 was also presented to the Panel meeting of 10 July 2003 and the Modification Report for P122 will also be presented to the Panel meeting of 14 August 2003.

During the Assessment Procedure for P123, the SSMG met four times, on 15 and 28 April 2003, 27 May 2003 and 24 June 2003, to assess P123, define the requirements for the solution to the Modification Proposal, consider the consultation responses and impact assessments and to agree the recommendations to be made to the Panel in respect of P123.

To assist in the assessment of P123:

- A High Level Impact Assessment, based on the Requirements Specification was issued to the BSC Central Service Agent and BSCCo, with responses received in time for inclusion in the industry consultation;

- An Assessment Consultation aimed at determining industry opinion of the proposed solution for P123, including the results of the High Level Impact Assessment of the potential solutions, and requesting information for assisting the SSMG assessment of P123, was issued on 4 June 2003, with responses received by 16 June 2003;
- A request for an Impact Assessment, based on the consultation document was issued in parallel with the assessment consultation, for industry impact assessment (MC00056), and BSC Central Service Agent and BSCCo for detailed level impact assessment.

The SSMG unanimously agreed that Proposed Modification P123 should be made. The SSMG noted that the consultation responses (section 11 of the Assessment Report) supported that opinion.

The Panel considered the Assessment Report at its meeting of 10 July 2003, and unanimously agreed to provisionally endorse the recommendations of the SSMG, that the Proposed Modification should be made. Therefore, the Panel agreed to submit P123 to the Report Phase.

The Panel further agreed that the Implementation Date should be should be 27 February 2004 (for the Spring 2004 BSC Season), should the Authority determination be received on or before 17 November 2003. Should an Authority determination be received after this date, but prior to 12 January 2004 then the Implementation Date should be 31 May 2004 (for the Summer 2004 BSC Season).

The Panel noted the BSC Central Service Agent development and implementation costs associated with Proposed Modification P123 of £3,000, (excluding ELEXON effort of approximately 70 man days) and the ongoing BSC Central Service Agent operate and maintain costs of approximately £0 per annum, provided that the number of Demand Capacity decreases do not exceed 1000 per annum (noting that if this threshold is exceeded, costs of £475 per man day effort will be incurred, not £475 per decrease). This excludes ELEXON operational effort of 10 man days per annum.

The draft Modification Report, containing the provisional recommendations of the Panel, was provided to Industry for consultation on 17 July 2003, allowing 11 (full) working days for respondents (responses due 1 August 2003).

*The consultation responses made in respect of the Draft Modification Report were received on 1 August 2003. [Pending Consultation]*

*[The Panel considered the draft Modification Report and the consultation responses made in respect of the report at its meeting of 14 August 2003 and ... pending deliberation]*

### **1.3 Rationale for Recommendations**

The Panel supported the rationale for the recommendations made by the SSMG with regards to Proposed Modification P123 and on the basis of this rationale the Panel provisionally recommended that Proposed Modification P123 should be made. The rationale of the SSMG is as follows:

The SSMG were unanimous in asserting that P123 better facilitates Applicable BSC Objective 3(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', namely because P123 improves competition by removing barriers to entry for certain industrial and commercial Suppliers, allowing them to maintain a more appropriate level of credit cover. This reduces their costs, thereby encouraging niche competitors and lowering the cost of market entry for new suppliers.

The SSMG also believed that, to a lesser extent, P123 better facilitates Applicable BSC Objective 3(d) 'Promoting efficiency in the implementation and administration of the balancing and settlement arrangements', because the amendments to the Credit Default process identified by P123 may have the

effect of improving efficiency in the Credit Cover and Credit Default arrangements, thus improving efficiency in BSCCo's handling of Credit Default.

The SSMG noted that the majority of the consultation responses made in respect of the assessment consultation (section 11 of the Assessment Report) supported the assertions of the SSMG with regards to the facilitation of the Applicable BSC Objectives.

#### **1.4 Rationale for Proposed Implementation Date**

During the Assessment Procedure for P123, the SSMG noted that the next likely Portfolio change would be for the April contracting round. The SSMG therefore indicated that it would be their preference to have an Implementation Date for P123 that would allow the mechanism proposed by the Modification to be in place in time for use prior to April 2004. The following sets out the timetable for the implementation, and provides the rationale for the Implementation Date provided for P123.

The solution to P123 agreed by the majority of the SSMG, requires the following to be undertaken during the implementation of the Modification Proposal:

- Amendment to the Code to include reference to the ability of a Party to make two downward changes to Demand Capacity per BM Unit and BSC Season, the requirement for BSCCo to maintain and make available the material doubt guidelines and the requirement for BSCCo to review evidence provided in respect of material doubt at the point of provision of the evidence by the relevant BSC Party;
- Implementing a mechanism to monitor the number of DC decreases, and to reject more than two per BSC Season for a BM Unit;
- Potential amendment to the BSCCo market monitoring system, TOMAS, for the purposes of verification of the Energy Indebtedness calculations in the determination of material doubt; and
- Amendment to the material doubt guidelines to set out the process whereby BSCCo determines and applies material doubt, with agreement of the material doubt guidelines by the Panel (potentially delegated to the Imbalance Settlement Group (ISG)).

It should be noted that the mechanism for monitoring the number of Demand Capacity decreases can be implemented either by the BSC Central Service Agent, by means of a manual solution (spreadsheet) in the Central Registration Agent (CRA), quoted as a £3,000 one off charge (no ongoing operational overhead), or by ELEXON, in Service Delivery (Customer Services Management (CSM)), quoted as 7 man days per annum.

It would therefore appear to be appropriate to implement the CRA solution and incur a one off development charge. However, this requires inclusion of the amendment in a BSC Systems Release. The first available release at this time will be the February 2004 Release, effectively meaning that the Implementation Date for P123 would be 1 March 2004 (i.e. coincident with the start of the following BSC Season).

There is still a requirement to develop the material doubt guidelines for P123 and Service Delivery have indicated a lead time requirement of 14 weeks for the purposes developing and agreeing the material doubt guideline.

Therefore, since the process proposed by P123 makes it desirable to implement the Modification at the start of a BSC Season (to enable the 2 changes in a BSC Season), and the first (practical) BSC Season following submission of the Modification Report to the Authority will commence on 1 December 2003, there is insufficient time to get P123 implemented before the Winter BSC Season starts. Furthermore, it

could be argued that the P123 only really needs to be in place in time for the April contracting round, given that implementation in time for the October (2003) round will not be reasonable. Therefore an Implementation Date of 27 February 2004 is proposed, thus putting P123 in place in time for the April 2004 contracting round.

The Modification Report will be provided to the Authority by 11 August 2003 for determination, and in order to meet the timetable for implementation for the Spring 2004 BSC Season, a determination will be required by 17 November 2003. Where a decision is not received by this date, then the BSC Season that P123 will be available for will be the Summer 2004 BSC Season, and the second Implementation Date, namely requiring an Authority determination by 9 January 2003, reflects this.

## 2 INTRODUCTION

This Report has been prepared by ELEXON Ltd., on behalf of the Balancing and Settlement Code Panel ('the Panel'), in accordance with the terms of the Balancing and Settlement Code ('BSC'). The BSC is the legal document containing the rules of the balancing mechanism and imbalance settlement process and related governance provisions. ELEXON is the company that performs the role and functions of the BSCCo, as defined in the BSC.

This Modification Report is addressed and furnished to the Gas and Electricity Markets Authority ('the Authority') and none of the facts, opinions or statements contained herein may be relied upon by any other person. An electronic copy of this document can be found on the BSC website, at [www.elexon.co.uk](http://www.elexon.co.uk)

## 3 HISTORY OF THE MODIFICATION

Modification Proposal P123 has been extensively assessed by the SSMG, and the detail of the assessment is provided in the Assessment Report for Modification Proposal P123 (Reference 1), and is therefore not repeated here.

## 4 DESCRIPTION OF PROPOSED MODIFICATION

The rationale of the SSMG, in determining the following solution, is set out in section 5 of the Assessment Report (Reference 1).

However, it should be noted that, in order to tie this solution back to the deliberations of the SSMG, the solution detailed in this section represents the following options considered and consulted on during the Assessment Procedure for P123:

- **Option 2:** Decreases to Demand Capacity mid BSC Season, without formal approval and without an associated CALF amendment; and
- **Material Doubt Option B:** Use the existing process for material doubt but enhance the current guidelines to include more formal guidelines on the type of calculations that BSCCo should be using for verifying material doubt, for example in the case of portfolio change and over holiday periods.

Therefore the solution / description of the Proposed Modification set out below is that proposed by the SSMG to the Panel, and subsequently by the Panel to the Authority as the solution giving effect to the agreed legal drafting for P123.

#### **4.1.1 Decreases in the Magnitude of Demand Capacity**

Parties will only be able to have two mid-season decreases to DC per BSC Season per Supplier BM Unit. If any more than two are received the CRA will reject them, noting that this requires amendment to the CRA validation rules.

There are two potential approaches for validating that there are only two DC changes per Supplier BM Unit per season, these are:

1. BSCCo retains a register of the DC changes and authorises only two decreases in DC magnitude per SVA BM Unit per season. This is consistent with the current informal process used by BSCCo and CRA where all DC changes are submitted to BSCCo for validation and authorisation before a change is made; or
2. CRA implements additional validation to ensure that only two decreases in DC magnitude per Supplier BM Unit per Season.

The obligation, currently in the Code, to increase the magnitude of DC if the Party is aware that the maximum expected metered volume of a BM Unit increases by 1% or 0.5MW, remains and will not be changed.

BSCCo may wish to increase the frequency of the monitoring to ensure that Parties were not consistently exceeding the registered Demand Capacity.

#### **4.1.2 Determination and Application of Material Doubt**

The process for establishing material doubt in itself will be unchanged. Parties will be required to provide sufficient evidence to demonstrate to BSCCo that their case is valid, such that BSCCo can reach a view on material doubt and carry out any necessary calculations prior to any notice being issued, so that a final determination can be reached as soon as possible after the receipt of a Credit Default notice.

The change to the current process for P123 (and P122) is that the material doubt process will include a reference to a Panel established guideline that BSCCo will be obliged to follow when reaching a determination on material doubt. The guideline may include a calculation that should be used by BSCCo when considering if there is an over calculation of Credit Cover Percentage. It should be noted that it is envisaged that the Panel will delegate authority for establishing and maintaining the material doubt guideline to the Imbalance Settlement Group (ISG). However, this should not be assumed.

Based on this calculation and on other circumstances as permitted in the guidelines and the Code, BSCCo will be able to reach a determination on material doubt in as short a period of time as possible. This method would allow Parties to replicate the calculation themselves and be more certain that material doubt would be called on the Credit Default notice, thus allowing BSCCo to withhold any authorisation notice in respect of the Credit Default notice.

The Code amendments proposed for P123 (and P122) oblige BSCCo to review any evidence submitted as soon as reasonably practicable following receipt of the evidence. Furthermore, the material doubt guidelines should recommend that BSCCo provide the relevant Party with an indication of the materiality of the discrepancy as soon as the evidence has been assessed, providing a degree of certainty.

BSCCo must verify the material doubt on receipt the Credit Default notice, to ensure that all circumstances merit the application of material doubt, in order to protect BSC Parties from the risk associated with a defaulting Party. However, BSCCo is expected to expedite the determination and

provide the Trading Party with verification of the application, or not, of material doubt as soon as is reasonably practicable following receipt of the Credit Default notice.

## **5 LEGAL TEXT TO GIVE EFFECT TO THE PROPOSED MODIFICATION**

For the legal drafting to support Proposed Modification P123 see attached document '**P0123RR\_Proposed Legal Text**'.

## **6 SUMMARY OF REPRESENTATIONS**

*[pending receipt]*

## **ANNEX 1 – REPRESENTATIONS**

*[pending receipt]*