



APRIL 2003

**INITIAL ASSESSMENT OF MODIFICATION
PROPOSAL P123 - ASSESSMENT OF
CREDIT COVER FOLLOWING A CHANGE IN
A PARTY'S PORTFOLIO**

Prepared by ELEXON Limited

Document Reference	P123IR
Version no.	1.0
Issue	Final
Date of Issue	4 April 2003
Reason for Issue	For Decision
Author	ELEXON Limited

I DOCUMENT CONTROL

a Authorities

Version	Date	Author	Reviewer	Change Reference
0.1	27/03/03	Joanne Ellis	Change Delivery	Initial draft for peer review
0.2	02/04/03	Joanne Ellis	Change Delivery / Service Delivery	Technical Review
0.3	03/04/03	Joanne Ellis	Change Delivery	Quality Review
1.0	04/04/03	Change Delivery	Change Delivery	Issued to Panel for decision

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 References

Reference	Document	Owner	Issue Date	Version
1	Modification Proposal P122 'Assessment of Credit Cover during holiday periods'		26/03/03	1.0

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1 SUMMARY

Modification Proposal P123 'Assessment of Credit Cover following a change in a Party's Portfolio' (P123), included in Annex 1, was raised on 26 March 2003 by BizzEnergy.

An initial assessment of P123 has identified that there are potential changes to BSCCo systems and processes and BSC Agent processes. Detailed assessment is required in order to quantify these impacts more accurately and to determine if P123 better facilitates achievement of the Applicable BSC Objectives. It is recommended that P123 be submitted to a 3-month Assessment Procedure.

This initial assessment has identified several issues that will need to be considered during the assessment of P123. Further details can be found in section 12 of this document, but they can be summarised as follows:

- P123 should be assessed by the Settlement Standing Modification Group (SSMG) with additional credit experts invited;
- P123 should be assessed in parallel with Modification Proposal P122 'Assessment of Credit Cover during holiday periods' (reference 1), as the issues are similar and they will benefit from a parallel Assessment Procedure;
- The SSMG should consider how BSCCo will pre-empt material doubt and what systems and processes are required to ensure that this is robust;
- Consideration should be given to the evidence that is required from a Party who requests a change to Demand Capacity (DC) and/or Credit Assessment Load Factor (CALF) due to a decrease in the net offtake of an SVA BM Unit;
- P123 only describes material doubt associated with instances of Level 1 Credit Default. Consideration should be given as to whether the process should be expanded to include material doubt associated with Level 2 Credit Default; and
- The SSMG should consider if BSCCo is the most appropriate organisation to carry out the alternative calculations.

On the basis of this Initial Written Assessment, the Balancing and Settlement Code Panel ('the Panel') is invited to:

- a) **DETERMINE that Modification Proposal P123 should be submitted to the Assessment Procedure in accordance with section F2.6 of the Code;**
- b) **AGREE the Assessment Procedure timetable such that an Assessment Report should be completed and submitted to the Panel for consideration at their meeting of 10 July 2003;**
- c) **DETERMINE that the Assessment Procedure should be undertaken by the Settlement Standing Modification Group; and**
- d) **AGREE any refinement to the Modification Group Terms of Reference.**

2 INTRODUCTION

This Report has been prepared by ELEXON Ltd. on behalf of the Balancing and Settlement Code Panel, in accordance with the terms of the Balancing and Settlement Code ('the Code'). The Code 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 Code.

3 DESCRIPTION OF MODIFICATION PROPOSAL

3.1 Background

P123 seeks to change conditions relating to the determination of Credit Cover following a change in a Party's portfolio. The issues that a Party currently faces can be summarised as:

- DC and CALF are currently set for a BSC Season and in general cannot be amended during the season;
- Portfolio changes, such as the loss of customers specified in P123, cannot be reflected in the DC/CALF values until the next BSC Season, which could potentially be some time away;
- Credit Cover Percentage (or Energy Indebtedness) uses DC/CALF and actual trading charges to provide an indication of the credit liability of the Party, see below for a more detailed explanation of the Credit Cover calculations; and
- Following a portfolio change, for which no changes to DC or CALF have been made, a Party's Credit Cover Percentage can be unrepresentative of their credit liability. In certain circumstances this may mean a Party either has to lodge additional Credit Cover, with a cost to that Party for doing so, or risk going into Credit Default.

P123 seeks to ensure that a more reflective Credit Cover Percentage can be determined, thereby removing the need for either posting additional Credit Cover or entering Credit Default. It seeks to do this by allowing BSCCo to pre-empt entry into Credit Default by that Party, by allowing material doubt on that Credit Default effectively before it happens and also seeks to allow a Party to change DC and/or CALF for reason of portfolio change. This is described in more detail in section 3.2.

The calculation for Credit Cover Percentage is directly proportional to a Party's Energy Indebtedness. In simple terms Energy Indebtedness is calculated from the approximated expected imbalance of the Party and an approximation of the Energy Imbalance Charges for that imbalance. The calculation is cumulative over 29 days, i.e. from the Settlement Period to initial payment and comprises two parts, Credited Energy Indebtedness and Actual Energy Indebtedness.

- a) Credited Energy Indebtedness: This is calculated from the BM Unit Credit Assessment Import or Export Capability which is based on GC or DC * CALF. This is used to calculate the average potential metered volume of the BM Unit. This is used for days for which there is no actual data available as the Interim Run (II) data is not available (in general, the first 9 days).
- b) Actual Energy Indebtedness: This is calculated from the actual trading data available (metered volumes and trading charges) for the remaining 20 days of the calculation. Issues can arise here as the metered data for SVA BM Units is not available at the II stage and will not be available until the Initial Settlement Run (SF). This can lead to two problems:
 - (i) the SF Run is generally 15 Settlement Days after the II Run and therefore if there has been a change in load for that Party, it will not be reflected in the calculation; and
 - (ii) days where SF data is not available the metered volumes are calculated by using data from an "equivalent day" which is the most recent Settlement Day, which is the same day of the week, for which the SF Run data is available.

3.2 Modification Proposal

P123 seeks to change the following conditions relating to the determination of Credit Cover following a change in a Party's portfolio:

- a) A Party should have the ability to request a change to DC and/or CALF, on the grounds of significant portfolio change, where there is reason to expect a material fall in net offtake at a BM Unit registered in SVA;
- b) These applications will be regardless of any applications for revision of CALF and DC made on any other grounds;
- c) A successful change to either CALF or DC, on the grounds of portfolio change, would act as a trigger for the following processes to be followed:
 - (i) BSCCo will be authorised by the Panel to use specific alternative measures to reassess the level of Actual Energy Indebtedness of the affected BM Unit. Currently where no II data is available, which is the case for SVA BM Units, SF data is used for calculation of Actual Energy Indebtedness. In circumstances where the portfolio has decreased this data may be unreflective of the latest metered volumes and therefore reassessment will be carried out for the latest position, i.e. adjusted for the portfolio change;
 - (ii) BSCCo and the Trading Party will disregard the Credit Cover percentage notified by the Energy Contract Volume Aggregation Agent (ECVAA) under Section M3.1.4 of the Code, where the Party is not on Credit Default from the re-assessed Actual Energy Indebtedness;
 - (iii) BSCCo will recalculate the Credit Cover percentage using appropriate calculations derived from the alternative measures, as soon as reasonably practicable after each Settlement Day;
 - (iv) Where these alternative calculations of Credit Cover apply, BSCCo may instruct ECVAA to suspend submission of Level 1 Credit Default Notices to the affected Party, or may use other means to nullify the effect of such notices. This is on the basis that the values derived from the alternative calculation provide evidence for material doubt that the ECVAA calculation of Actual Energy Indebtedness will be correct. This includes suspension of the start of the Query Period.

The Proposer believes that currently for SVA registered BM Units there can be a significant change in the Metering Systems that make up the BM Unit following the spring and autumn contract rounds, or at other times where there is a significant portfolio change. The Proposer suggests that this especially applies to BM Units that are predominantly made up of Industrial and Commercial customers. The Proposer suggests that where the portfolio change leads to a reduction in BM Unit Credit Assessment Export Capability ($BMCAIC = DC * CALF$) the Credit Cover requirements can be skewed against the affected Party. The implication of this seems to be that a Party may be required to lodge additional Credit Cover, in excess of their actual credit liability under the Code, and unrepresentative of the credit risk they actually present.

The Proposer suggests that a revised portfolio cannot usually be accurately determined until very close to the start of the new contracts. This means that the information on which a revised DC and CALF can be determined for such a BM Unit is usually not available at the time the CALF and DC are determined for the BSC Seasons. Furthermore, the CALF/DC for the months preceding the change of portfolio are likely to be reflective of the pre-portfolio change position, but then may become unreflective at the start of the new contract, when the portfolio changes. In order to address this issue, P123 seeks to allow a reduction in DC and/or CALF made on specific grounds of portfolio reduction.

The Proposer notes that currently BSCCo can only determine that the assessment of Actual Energy Indebtedness is erroneous once the ECVAA has submitted a copy of the Level 1 Credit Default Notice to the Party and to BSCCo. It should be noted that even then, BSCCo can only determine that there is material doubt in the calculation if:

- BSCCo is aware that the ECVAA has not received relevant II Run data from the Settlement Aggregation Agent (SAA), Section M1.2.1(e)(i);
- BSCCo has substantial evidence or other reasons to believe that the data to be derived from the SF Run for that Party and that Settlement Day are likely to be significantly different from the corresponding II Run data received by ECVAA from the SAA, Section M1.2.1(e)(ii); or
- BSCCo is aware that there is material doubt as to whether the systems and processes used by ECVAA are giving correct determination of the values of Credit Cover Percentage, Section M3.4.3(a).

A Party then has a Query Period of 24 hours, commencing from the time the default notice is received by the Party, regardless of holidays and weekends, to establish the accuracy of the information used in the calculation of Actual Energy Indebtedness. This requires both the Party and BSCCo to provide expensive resources in order collate the necessary information as BSCCo currently has no authority under the Code to anticipate the information, even where it has good reason to materially doubt the figures coming from the ECVAA. To address this, P123 seeks to allow BSCCo to maintain calculations for a period of time based on the approved alternative method and to use such calculations in preference to those made by the ECVAA in the assessment of the Trading Party's Credit Cover Percentage. BSCCo should also be allowed to suspend, or suspend the effect of, Level 1 Credit Default Notices raised by the ECVAA that are based on calculations using the "pre-portfolio change" metered volumes i.e. pre-empt material doubt as a consequence of Section M1.2.1(e) of the Code.

The Proposer believes that P123 will better facilitate the achievement of Applicable BSC Objective (c), increasing competition in the supply and generation of electricity. The rationale given for this is that a Party with a significantly reduced portfolio (or a reorientation away from base load type customers) will face an excessive calculation of Energy Indebtedness, which will damage the Party's competitive position. This distortion of the competitive market tends to discriminate against smaller Suppliers who specialise in the industrial and commercial sector, as the scale of the impact on their business is likely to be more material, potentially placing them in breach of the Code.

In addition the Proposer believes that P123 seeks to promote the efficient operation of the Balancing and Settlement Arrangements, by reducing the instances where unnecessary Level 1 Credit Default notices are given and which must be queried and resolved in a tight timescale.

4 IMPACT ON BSC SYSTEMS AND PROCESSES

BSC System / Process	Potential Impact of Proposed Modification
Credit Checking	Potential impact on ECVAA systems and processes for handling the credit checking process if BSCCo request that they suspend submission of Level 1 Credit Default Notices.

5 IMPACT ON OTHER SYSTEMS AND PROCESSES USED BY PARTIES

No impacts identified.

6 IMPACT ON DOCUMENTATION

6.1 Impact on Balancing and Settlement Code

BSC Section	Potential Impact of Proposed Modification
K: Classification and Registration of Metering Systems and BM Units	The definition of DC and the rules for changing it may need to be amended.
M: Credit Cover and Credit Default	The rules for giving "Authorisation by BSCCo" for Credit Default and the application of material doubt may need to be amended. The rules for amending CALF may need to be amended.

6.2 Impact on Code Subsidiary Documents

Code Subsidiary Document	Potential Impact of Proposed Modification
BSC Procedures	Changes to BSCP15 "BM Unit Registration" may be required to reflect the process for changing DC and CALF due to a change in portfolio.
BSC Service Descriptions	The ECVAA Service Description may need to be amended if the circumstances in which they need to suspend the submission of Level 1 Credit Default notices are changed by P123. The CRA Service Description may need amendment if the rules for changing CALF and DC are amended.

6.3 Impact on Core Industry Documents

No impacts identified.

6.4 Other Documents and Processes

Item	Potential Impact of Proposed Modification
CALF Guidelines	The CALF Guidelines give details of how a CALF value is determined for different types of BM Unit. These may need to be amended with details of any new procedures agreed during assessment of P123.
Obligations Register	This will need to be updated with any new obligations that are placed on BSCCo as a result of P123.
BSC Business Process Model	The BSC Business Process Model will need to be updated with any changes in process that come out of P123.

7 IMPACT ON OTHER CONFIGURABLE ITEMS

No impacts identified.

8 IMPACT ON BSCCO AND THE BSC PANEL

Area of Business	Potential Impact of Proposed Modification
BSC Panel	There will be additional workload on the Panel or its subcommittee, the Imbalance Settlement Group if there were a lot of additional CALF and DC values to be determined throughout the year.
ELEXON Systems	A system may need to be developed to calculate the materiality of a change in CALF / DC and to reassess the level of Actual Energy Indebtedness of a BM Unit.
ELEXON Procedures	Impact on procedures for dealing with CALF and DC revisions. Impact on procedures used by the Credit team for analysing if material doubt has been established and for dealing with ECVAAs.
Other (e.g. costs, staffing, etc.)	There may be a need for additional BSCCo staff if the process places additional obligations on BSCCo.

9 IMPACT ON FINANCIAL ARRANGEMENTS AND BUDGET

No impacts identified.

10 IMPACT ON BSC AGENT CONTRACTUAL ARRANGEMENTS

No impacts identified.

11 PROCESS AND TIMETABLE FOR PROGRESSING THE PROPOSAL

BSCCo recommends that this Modification Proposal be submitted to the SSMG with additional credit experts, for further assessment. The SSMG should be actioned to provide its report to the Panel by 10 July 2003.

The rationale for a 3-month Assessment Procedure is to allow the SSMG sufficient time to assess the issues associated with P123 and determine if it better facilitates achievement of the Applicable BSC Objectives. A proposed timetable is attached in Annex 2.

12 ISSUES

The following issues will need to be considered and addressed by the SSMG when progressing P123.

- Industry experts with experience of dealing with credit issues should be invited to join the SSMG for assessment of P123;

- P123 should be assessed in parallel with P122. Although P122 and P123 are sufficiently different to not be amalgamated, the issues associated with them are of a similar nature and therefore they will benefit from a parallel Assessment Procedure;
- The proposed revisions to the material doubt process include a requirement for BSCCo to get the Panel's approval for the granting of material doubt. It is unclear if this just for pre-emptive material doubt or if it is for all cases. In any case this represents an additional requirement and could delay the material doubt process, which P123 is seeking to streamline;
- The introduction of pre-emptive material doubt, assessed by BSCCo, aims to achieve a reduction in out-of-hours cover that needs to be provided by the Party or BSCCo. However, it is not clear when the material doubt period ends. This will require ongoing monitoring by BSCCo and may not necessarily reduce the out-of-hours cover.
- DC is defined within the Code as the maximum expected magnitude of the BM Unit Metered Volume within a BSC Season. The Modification Group should consider if it is appropriate to allow a Party to decrease the magnitude of their DC part way through a BSC Season even if they have already achieved the maximum expected magnitude of the BM Unit Metered Volume within that BSC Season. If this were allowed, the implications that this will have on the Transmission Company and any other bodies that uses a Party's declared DC for other purposes, should be considered.
- The Modification Group should consider the kind of evidence that Parties will be required to submit in order that BSCCo can ensure that the Party has in fact lost customers or Metering Systems and should be allowed to decrease their DC or change their CALF value for this reason.
- Consideration should be given to whether the BSC Seasons could be aligned with contract rounds this may address the defect identified in P123. The Modification Group should consider what impact this will have on other Parties and other systems and processes.
- As the Code is currently written, a Party may challenge their assigned CALF value within 2 months of a change to the CALF value or to the CALF guidelines. The Modification Group should determine if it is appropriate to allow a Party to change CALF themselves or whether they should be able to appeal the value when they have a change in portfolio. They should also consider if there should be a limit to the amount of times a Party can do this within a season, and if it would be appropriate to keep the same appeal system for putting this into use.
- Currently the Code allows Parties to change their CALF value by appealing to the Panel or ISG. This has in the past been used to allow a Party to account for a change in portfolio and obtain a correct value of BM Unit Credit Assessment Import Capability. In this case the CALF value will not necessarily be representative of the Load Factor of the Party but as the DC cannot currently be decreased, it is a means to reach the same effect. The Modification Group should consider if this the most appropriate method and if so then agree it be formalised in the CALF Guidelines and consider if there is any need to allow a Party to be able to decrease their DC mid-season to allow for a change in portfolio;
- The Modification Group should consider if BSCCo is the most appropriate person to carry out the calculations and if it would not be more appropriate for someone else to do these calculations; and
- P123 only mentions the processes associated with Level 1 Credit Default. Consideration should be given to whether the process should be expanded to include the circumstances of Level 2 Credit Default.

ANNEX 1 MODIFICATION PROPOSAL

Modification Proposal – F76/01	MP No: 123 <i>(mandatory by BSCCo)</i>
Title of Modification Proposal <i>(mandatory by originator):</i> Assessment of Credit Cover following a change in a Party's Portfolio	
Submission Date <i>(mandatory by originator):</i> 26 th March 2003	
Description of Proposed Modification <i>(mandatory by originator)</i> <ol style="list-style-type: none"> 1. Whenever there is reason to expect a material fall in net offtake at a BMU registered in SVA due to a change in the composition of metering systems comprised in that BMU, a Party may apply to reset both the Credit Assessment Load Factor (CALF) and the Demand Capacity (DC) of that BMU on the grounds of significant portfolio change. 2. These applications will be regardless of any applications for revision of CALF and DC made on any other grounds. 3. A successful application to change either the CALF or the DC would act as a trigger enabling the measures described in paragraphs 5 and 6 below to be used. 4. The revised CALF and/or DC will apply from a requested date regardless of the values prevailing at the start of the BSC season in question. 5. Following such change in the portfolio, BSCCo can be authorised by the Panel to use specific alternative measures to reassess the level of Actual Energy Indebtedness of the affected BMU where such measures are deemed more likely to reflect the level of metered energy offtaken at the BMU for the purposes of Energy Indebtedness calculation. BSCCo and the Trading Party will consequently disregard the Credit Cover percentage notified by the ECVAA under M3.1.4 for that Trading Party and BSCCo will recalculate such Credit Cover percentage using appropriate calculations derived from the alternative measures as soon as reasonably practicable after each Settlement Day. 6. Where such alternative calculations apply, BSCCo may instruct the ECVAA to suspend the submission of level 1 credit default notices (specified in M3.2.1) to the affected party or may use other means to nullify the effect of such notices issued (including the suspension of the start of the Query Period) on the basis that the values derived from the alternative calculation represent material doubt that the ECVAA calculation of Actual Energy Indebtedness offers a correct determination. 	
Description of Issue or Defect that Modification Proposal Seeks to Address <i>(mandatory by originator)</i> <p>For a Supplier with a BMU registered in SVA, there can be a significant change in the meter systems making up that BMU following the spring and autumn contract rounds or at other times where there is a significant portfolio change. This applies especially to portfolios that are predominantly in the Industrial and Commercial sector. Where the portfolio change leads to a reduction in BMCAIC (DC * CALF) the assessment of credit cover requirements can be skewed seriously against the affected Party.</p> <p>Typically, a revised portfolio cannot be accurately determined until very close to the start of new contracts. This means that the information on which a revised DC and CALF can be determined for such a BMU is usually not available at the time the CALF and DC are determined for the seasons. Furthermore, the CALF/DC for the months preceding the change of portfolio are likely to be reasonable on the basis of the original determination</p>	

Modification Proposal – F76/01	MP No: 123 <i>(mandatory by BSCCo)</i>
<p>but then may become materially inaccurate subsequently. In order to address this issue, this proposal seeks to allow a reduction in DC and/or CALF made on specific grounds of portfolio reduction.</p> <p>A change in portfolio affecting an SVA BMU can also significantly impact the calculation of Actual Energy Indebtedness where that is based on a share of GSP Group offtake that was significantly lower than the share prevailing following the portfolio change. This miscalculation will persist for a period of approximately 35 days until such time as the share of GSP Group take is calculated on the basis of the new portfolio. To address this, this proposal seeks to allow specific alternative measures to be applied by BSCCo for the recalculation of the Trading Party's Actual Energy Indebtedness that are more likely to reflect the metered offtake at such a BMU following a portfolio change.</p> <p>Under M3.4.3(a), BSCCo can only determine that the assessment of Actual Energy Indebtedness is erroneous once the ECVAAs has submitted to it a copy of the level 1 default notice that has been submitted to the affected party. This allows the Party to raise a default query notice within a Query Period of 24 hours commencing from the time the default notice was received by the Party. This Query Period is regardless of holidays and weekends requiring both the Party and BSCCo to provide expensive resources in order to establish the materiality of any doubt as to the accuracy of the information used in the calculation of Actual Energy Indebtedness. BSCCo has no right to anticipate the information even where it has good reason to materially doubt the figures coming from the ECVAAs. To address this, this proposal seeks to allow BSCCo to maintain calculations for a period of time based on the approved alternative method and to use such calculations in preference to those made by the ECVAAs in the assessment of the Trading Party's Credit Cover Percentage and to suspend, or suspend the effect of level 1 default notices raised by the ECVAAs that were based on the original methodology.</p>	
<p>Impact on Code <i>(optional by Originator)</i></p>	
<p>Impact on Core Industry Documents <i>(optional by Originator)</i></p>	
<p>Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties <i>(optional by originator)</i></p> <p>It is likely that the processes required within this proposal will only be activated periodically and so manual systems operated by BSCCo can be substituted for systems changes that would otherwise need to be implemented by the ECVAAs.</p> <p>BSCCo will have a mandated alternative methodology for assessing material doubt as to the ECVAAs calculation, exercised under the authority of the Panel. Given that the process will be triggered by a recalculation of DC and/or CALF, it will be feasible to calculate a share based on BMCAIC as a proportion of summated BMCAIC for all the SVA BMUs in a GSP Group and use this as a scaling factor for reducing QM_{ij} relative to that calculated by the ECVAAs in T4.2.2 (noting that BMCAIC is used as a proxy for QM_{ij} in the credit calculations). Because this share will only change when there is a change to any DC or CALF that affects the GSP Group, this share will be reasonably constant in the short term. This can be used to either reassess all Trading Charges or potentially just to reassess the component of Trading Charges representing imbalance charges.</p> <p>Furthermore, BSCCo will be able to use this methodology to recalculate Energy Indebtedness for the affected Party on an ongoing basis and will be able to reassess Actual Energy Indebtedness before any level 1 default notice is raised and this can therefore be done in normal business hours.</p>	
<p>Impact on other Configurable Items <i>(optional by originator)</i></p>	

Modification Proposal – F76/01	MP No: 123 <i>(mandatory by BSCCo)</i>
Justification for Proposed Modification with Reference to Applicable BSC Objectives <i>(mandatory by originator)</i>	
<p>A Trading Party with a significantly reduced portfolio (or a reorientation away from base load type customers) will face an excessive calculation of Energy Indebtedness, which will damage the Party's competitive position. This distortion of the competitive market tends to discriminate against smaller Suppliers who specialise in the industrial and commercial sector, as the scale of the impact on their business is likely to be more material, potentially placing them in breach of the Code.</p> <p>This Modification is in line with Condition C3 (3)(a) to (c) of the Transmission Licence, namely: promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase (as defined in the Transmission Licence) of electricity.</p> <p>This also seeks to promote the efficient operation of the BSC by reducing the instances where unnecessary level 1 default notices are given, which must be queried and resolved in a tight timescale.</p>	
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Attachments: No <i>(delete as appropriate) (mandatory by originator)</i>	
If Yes, Title and No. of Pages of Each Attachment:	

ANNEX 2 PROPOSED TIMETABLE FOR PROGRESSION

