

What stage is this document in the process?

01 Initial Written Assessment

02 Definition Procedure

03 Assessment Procedure

04 Report Phase

Request to raise a Modification Proposal

Aligning BSC interest calculation requirements with the FAA calculation method and P235 principles

ELEXON requests the BSC Panel raise a Modification Proposal to bring the BSC requirements for four FAA interest calculations in line with the principles of accuracy and fairness established by P235.



ELEXON recommends:

The attached Modification Proposal is raised and is progressed to the Report Phase.



Impact of approving this modification: **Low**

This modification will align the Code with the calculation which the Funds Administration Agent already uses



Impact of rejecting this modification: **High**

Rejection could result in system and process changes for the Funds Administration Agent and for BSC Parties

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About this document:

This document invites the BSC Panel to raise a Modification to the BSC on efficiency grounds. The BSC Panel is asked to consider the recommendations and agree that a Modification be raised and progressed straight to the Report Phase with a Modification Report to be presented on January 2010 Panel Meeting.

Should the BSC Panel choose to raise this Modification Proposal, this document also constitutes an Initial Written Assessment (IWA).

Further information is available in the Modification Proposal form which can be found in Attachment A to this document.



Any questions?

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1. Why Change?

Background

Modification P235

The Authority approved Modification Proposal [P235](#) on 30 June 2009, with a retrospective Implementation Date of 27 March 2001 (NETA¹ Go-Live).

P235 brought the BSC requirements for calculating interest on **Reconciliation Charges** in line with the actual calculations which the Funds Administration Agent (FAA) has used since NETA Go-Live.

The BSC was amended to clarify that interest on Reconciliation Charges should be calculated:

- Over the period from (and including) the Payment Date of the corresponding Initial Settlement Run, up to (but excluding) the Payment Date of the current Reconciliation Run;
- On a daily compound basis (i.e. the amount on which interest is calculated for each day in the above period includes the accumulated interest levied on previous days); and
- Using the applicable Base Rate for each day in the calculation period (thereby taking account of any changes in the Base Rate during this period).

The P235 Modification Group considered in detail the principles underlying the calculation of reconciliation interest and concluded that:

- The calculation of interest should reflect the principle behind the BSC's Reconciliation process (that Reconciliation Charges should adjust BSC Parties' payments as if the 'correct' monies had been exchanged on the Payment Date of the Initial Settlement Run), and the **time value** of money to Parties;² and
- The actual FAA calculations more fairly and/or accurately reflected this principle.

Although Modification P235 removed the uncertainty over the method used by FAA to calculate interest on **Reconciliation Charges**, its scope was limited to that one calculation. ELEXON have therefore been investigating whether any of the other interest calculations specified in the BSC require clarification.

Interest Calculation Issues

We have identified a further 4 calculations that are unclear on how interest is calculated. These calculations are for:

- 1) Interest on Ad-Hoc Trading Charges relating to **Extra-Settlement Determinations** (ESDs). In particular, Section U2.2.3(i) of the BSC requires interest to be calculated if an ESD is followed by a subsequent Settlement Run for the same Settlement Day;
- 2) Interest on payments relating to Contingency Provisions (i.e. Black Start, Manifest Errors, and Q8 compensation);
- 3) Interest relating to Initial Settlement Runs for which the Payment Date is delayed by more than a week; and

¹ The New Electricity Trading Arrangements (NETA) replaced the previous Electricity Pool arrangements in 2001.

² The 'time value' (sometimes called the 'earning value') of money means the principle that it is better to receive an amount of money today rather than an equal amount in the future, because of the interest that can be earned on it between now and then. So Parties who have overpaid at the Initial Settlement Run or subsequent runs should be compensated (through interest) for the loss of use of their money during the period of overpayment. Similarly, Parties who have initially underpaid should pay interest for the period of the underpayment, to reflect their ability to use money which they would not otherwise have had.

Reconciliation Charges

Reconciliation Charges are the adjustments made to a Party's Trading Charges following a Reconciliation Run. These adjustments are intended to make it as if the metered data determined at that Reconciliation Run had been submitted at the Initial Settlement Run.



What is an ESD?

An ESD is a determination, outside Volume Allocation Runs and Settlement Runs, of Trading Charges (or adjustment and apportionment in respect thereof), required to be carried out by the Panel.

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4) Interest relating to late payment of Trading Charges ('Payment Defaults').

Although the identified calculations are varied in nature, they all arise as a result of Trading Charges being amended and/or paid after the Payment Date of the Initial Settlement Run. The principles agreed by the P235 Modification Group for interest on Reconciliation Charges should therefore also apply to these calculations.

The following two aspects of the current BSC requirements for these calculations do not reflect the P235 principles of fairness and/or accuracy:

1) The BSC does not make it clear that interest should be calculated on a daily compound basis, using the interest rate applicable to each day.

This issue affects the:

- ESD provisions in U2.2.3(i);
- Contingency Provisions for Black Start in G3.3.6(a), Manifest Errors in Q7.6.5(a) and Outage Compensation in Q8.3.1(b);
- Postponed Initial Settlement Run provisions in N6.6.2; and
- Non-paying BSC Debtors provisions in N9.4.1.

The current BSC wording could be read as implying the use of 'simple interest'. This would mean that the amount on which interest is charged would remain the same for each day in the calculation period, ignoring any interest accumulated on previous days. The BSC could also be read as implying (although it is somewhat ambiguous) that a single Base Rate should be applied to the whole calculation period, ignoring any changes in the Base Rate during that period.

This would not accurately reflect the principle behind adjusting Trading Charges or the time value of money to BSC Parties.

2) The ESD provisions in U2.2.3(i) state that, where an ESD is followed by a subsequent Settlement Run for the same Settlement Day, interest should be calculated for the period from the Payment Date of the ESD 'to the Payment Date in respect of such Settlement Run'.

When interpreted in conjunction with X2.3.1³ this implies that the period for which interest is calculated includes, rather than excludes, the Payment Date of the current Reconciliation Run.

While the materiality of this issue is small, the BSC requirement represents an (albeit minimal) over-calculation of interest. This is because Parties have until the end of the Payment Date to make payment, and any payment does not become overdue until the following day.

³ X2.3.1 says that where any period under the BSC is to run to a given day, such period shall run to the end of that day.

2. Solution

Overview

We are recommending that the BSC Panel raises a Modification Proposal to bring the BSC's requirements for four further FAA interest calculations in line with the principles of accuracy and fairness established by the P235 Modification Group.

The FAA's actual calculations are already consistent with the P235 principles. This Modification Proposal is therefore **not expected to impact current processes**. Rather it will, like P235, bring the BSC in line with established industry practice.

The Proposed Modification should have a **retrospective Implementation Date** of NETA Go-Live, for the same reasons as the Modification Group and the BSC Panel put forward for P235. These are that calculating interest on a compound basis has always been the intended and correct method, and that confirming this retrospectively would protect Parties from the risk and cost of calculations being challenged through the Trading Disputes process. The P235 Group and the Panel agreed that, while retrospective changes are normally to be avoided, in these specific circumstances retrospection would remove (rather than create) uncertainty.

Proposal

The draft Modification Proposal (Attachment A) seeks to amend the interest calculations set out below.

Provisions affected by issues identified in Section 1	Solution
ESD provisions	Amend Section U2.2.3(i) of the BSC
Contingency Provisions for Black Start, Manifest Errors and Outage Compensation	Amend Section G3.3.6(a), Q7.6.5(a) and Q8.3.1(b) of the BSC
Postponed Initial Settlement Run	Amend Section N6.6.2 of the BSC
Non-paying BSC Debtors	Amend Section N9.4.1 of the BSC

For more information, please refer to the Proposed Draft Legal Text in Attachment B to this document.

Materiality

Given the relatively low materiality of the issues described in Section 1 (compared to that addressed by P235), they have been seen until now as low priority.

Interest Calculations	Frequency
1) Ad-Hoc Trading Charges relating to ESDs	Never required
2) Payments relating to Contingency Provisions	Infrequent (less than 4 times a year)
3) Initial Settlement Runs for which the Payment Date is delayed by more than a week	Never required
4) Late payment of Trading Charges ('Payment Defaults')	Any frequency (occurs nearly everyday) The value of interest incurred is minimal (ranged from £2,60 - £1,250 per quarter across all Parties)

3. Why Direct to Report Phase?

Self evident change

The BSC Panel has the ability to progress a Modification straight to the Report Phase where the recommendation which the Panel should make to the Authority in relation to such Modification Proposal would generally be considered to be self evident (BSC paragraph F2.2.4).

We are recommending that this Modification proceeds directly to the Report Phase on this basis because:

- The principle of aligning BSC interest calculation requirements with FAA calculation methods was agreed under Modification P235, which aligned the BSC requirements and interest calculation methods with regard to Reconciliation Settlement Runs;
- This Modification seeks to address the remaining interest provisions in the Code using the same calculation principles established by P235;
- The material impact of this Modification is minimal due to the infrequent use of the remaining interest provisions; and
- The retrospective implementation approach utilised by P235 was unanimously supported by the industry (click [here](#) for a copy of the P235 Report Phase Consultation Responses).

We therefore recommend that the Panel determines that this Modification should proceed directly to Report Phase pursuant to paragraph F2.2.3(b)(iii) of the Code.



What is a self-evident change?

The Panel would usually proceed a change directly to the Report Phase where the Modification Proposal is of a minor or inconsequential nature and/or where the recommendation which the Panel should make to the Authority in relation to such Modification Proposal would generally be considered to be **self-evident**.

4. Applicable BSC Objectives

ELEXON is able to recommend that a Modification Proposal is raised by the BSC Panel where it is considered to better facilitate **Applicable BSC Objective (d)** as described in paragraph 2 of the Transmission Licence.

This Modification would align the BSC with the actual method undertaken by the FAA whose method of calculating interest is fairer and/or more accurate than the method detailed in the BSC.

To align the BSC with the actual method undertaken by the FAA will remove any confusion over how interest is calculated, and will provide clarity to participants. This will promote transparency and efficiency, thereby better facilitating Applicable BSC Objective (d).



Description of BSC Objectives

- a) Efficient discharge of the obligations of the Transmission Licence.
- b) Efficient, economic and co-ordinated operation of the national electricity transmission system.
- c) Promoting effective competition in the generation and supply of electricity and in the sale and purchase of electricity.
- d) Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

5. Proposed Progression

If the Panel agrees to raise the Modification Proposal, we will progress the Modification in line with the approach set out below.

Timetable

Event	Date
Request Panel to raise a Modification Proposal	10 December 2009
ELEXON issues Report Phase Consultation	14 December 2009
Consultation responses due	04 January 2010
Draft Modification Report presented to Panel	14 January 2010

Costs

Estimated progression costs based on proposed timetable	
Meeting costs (including Modification Group member expenses)	£0
Non-ELEXON legal and expert costs	£0
Service Provider impact assessment costs	£0
ELEXON resource	4 man days, equating to £960

Recommended Implementation Date

We recommend the modification would be implemented **retrospectively** back to NETA Go-Live on 27 March 2001.

Under this approach it would be as if the inconsistencies between the FAA interest calculation and the Code had never occurred. If approved, Parties could not raise Trading Disputes against any interest calculations (past or future).

For changes to FAA Service Description, we would update the Service Description in the next available Release to follow the Authority's approval of the modification, since the Service Description is not a priority, as the Code takes precedence and we would simply be amending it to mirror the Code.

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6. Likely Impacts

Impact on BSC Systems and process

None identified.

Impact on BSC Agent/service provider contractual arrangements

None identified.

Impact on BSC Parties and Party Agents

Approving this Modification Proposal will have no impact on BSC Agents' or BSC Parties' systems and processes. This is because it will align the BSC with the calculations which the FAA already uses.

However, rejecting this Modification Proposal could result in costs to the FAA (and possibly to Parties) to align systems and processes with the BSC. It could also result in the risk and costs of calculations being challenged through the Trading Disputes process.

Impact on Transmission Company

None identified.

Impact on ELEXON

None identified.

Impact on Code

- ESD provisions in **U2.2.3(i)**;
- Contingency Provisions for Black Start in **G3.3.6(a)**, Manifest Errors in **Q7.6.5(a)** and Outage Compensation in **Q8.3.1(b)**;
- Postponed Initial Settlement Run provisions in **N6.6.2**;
- Non-paying BSC Debtors provisions in **N9.4.1**

Impact on Code Subsidiary Documents

Changes will also be needed to the FAA Service Description, which is based on the current BSC wording.

Impact on Core Industry Documents and other documents

None identified.

Impact on other Configurable Items

None identified.

7. Recommendations

ELEXON invites the Panel to:

- **NOTE** the 4 calculations identified in Section 1 of this document where the BSC is unclear on how interest is calculated; and
- **AGREE** to raise the attached Modification Proposal to bring the BSC requirements for these interest calculations in line with the principles of accuracy and fairness established by the P235 Modification Group.

If appropriate, the Panel is also invited to:

- **DETERMINE** that this Modification Proposal progresses directly to the Report Phase;
- **AGREE** a provisional recommendation that the Modification Proposal should be approved;
- **AGREE** a provisional retrospective Implementation Date of 27 March 2001;
- **AGREE** that the draft legal text delivers the intention solution (subject to any consultation responses received during the Report Phase); and
- **AGREE** the timetable such that a Draft Modification Report is completed, issued for consultation, and submitted to the Panel at its meeting on 14 January 2010.

8. Further Information

You can find more information in:

Attachment A: Modification Proposal Form

Attachment B: BSC Legal Text Proposed