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**INITIAL ASSESSMENT OF
MODIFICATION PROPOSAL P76 -
Anomalies Associated With
Negative Quantities Of Credit Cover**

Prepared by ELEXON Limited

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I DOCUMENT CONTROL

a Authorities

Version	Date	Author	Signature	Change Reference
0.1	08/04/02	Trading Development		Draft for peer review
0.2	10/04/02	Trading Development		Draft for peer review
0.3	11/04/02	Trading Development		For formal review
1.0	11/04/02	Trading Development		For Panel Decision

Version	Date	Reviewer	Signature	Responsibility
0.1	08/04/02	Trading Development		Peer Review
0.1	08/04/02	Trading Operations		Peer Review
0.2	11/04/02	Trading Strategy		Peer Review
0.3	11/04/02	Trading Development		Formal Review

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

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II CONTENTS TABLE

I	Document Control.....	2
a	Authorities.....	2
b	Distribution.....	2
c	Intellectual Property Rights and Copyright.....	2
II	Contents Table	3
1	Summary	4
1.1	Modification Proposal P76.....	4
1.2	Recommendation.....	4
2	Introduction.....	4
3	Description of the Modification Proposal.....	5
4	Impact on BSC Systems and Processes.....	6
5	Impact on Other Systems and Processes Used by Parties.....	6
6	Impact on Documentation	6
6.1	Impact on Balancing and Settlement Code	6
6.2	Impact on Code Subsidiary Documents	6
7	Impact on Other Configurable Items	6
8	Impact on ELEXON.....	7
9	Process and Timetable for Progressing the Proposal.....	7
10	Issues	7
Annex 1	– Modification Proposal.....	8

1 SUMMARY

1.1 Modification Proposal P76

An initial assessment of Modification Proposal P76 has identified the following potential areas of impact and issues to be considered:

- There are current anomalies within the Energy Indebtedness calculations that can potentially lead to a Trading Party not being flagged as being in a state of Credit Default despite not having enough Credit Cover to secure their outstanding settlement liabilities. This occurs in the specific circumstance where the amount that the Party has not paid exceeds their Energy Credit Cover, then the result will be a negative Energy Credit Cover, which may not place the Trading Party in Credit Default even though they do not have enough Credit Cover to secure their outstanding settlement liabilities.
- The Modification proposes three different methods of dealing with these anomalies. These are:
 1. The definition of Credit Cover Percentage in Section M3.1.1 could be amended to take into account negative Credit Cover.
 2. The definition of Credit Cover could be modified to reflect that the amount of non-payments should be deducted from the amount of credit lodged, provided the Credit Cover never becomes less than zero.
 3. Alternatively, the definition of Energy Indebtedness could be modified to include the amount of unpaid Trading Charges.
- However, the impact of this Modification cannot be fully assessed until the solution has been fully defined by the Modification Group. Any amendments that affect the credit status of Parties could have a substantial impact on the Energy Contract Volume Aggregation Agent (ECVAA) and Funds Administration Agent (FAA) BSC systems. In addition it may have a significant impact on the ability of Parties ability to successfully balance their credit status over a period of days.

1.2 Recommendation

The Panel is invited to:

- **NOTE the results of the Initial Written Assessment;**
- **DETERMINE that Modification Proposal P76 be submitted to the Assessment Procedure (in accordance with Section F2.6 of the Code);**
- **AGREE the Assessment Procedure timetable and that the Assessment Report be submitted to the Panel meeting on 18 July 2002;**
- **APPOINT the Credit Modification Group to consider the Modification; and**
- **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 ('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.

An electronic copy of this document can be found on the BSC website, at www.elexon.co.uk

3 DESCRIPTION OF THE MODIFICATION PROPOSAL

Modification Proposal P76 was raised by British Gas Trading on the 8 April 2002. This proposal seeks to remedy a potential issue with the way in which Credit Cover is used in Energy Indebtedness calculations for defaulting Trading Parties. The issue arises as a consequence of the link between the Payment Default procedure and Credit Default procedure. If a Trading Party does not pay their Trading Charges by the relevant Payment Date then they are in Payment Default, and the amount of non-payment is deducted from the current level of Credit Cover. This new Credit Cover is notified to the ECVA and used in the Energy Indebtedness calculations for that Trading Party.

In the specific circumstance where the amount that the Party has not paid exceeds their Energy Credit Cover, then the result will be a negative Energy Credit Cover. The rules for assessing Parties' Credit Cover Percentages do not handle this situation robustly, and may fail to place the Trading Party in Credit Default even though they do not have enough Credit Cover to secure their outstanding settlement liabilities.

For example: if a Trading Party's Credit Cover is 100MWh and their Energy Indebtedness is 200MWh, their Credit Cover Percentage will be 200% and they will be in Credit Default. However if the Trading Party fails to pay Trading Charges equivalent to 200MWh then their Energy Credit Cover will become -100MWh. If the Energy Indebtedness stays the same, the Credit Cover Percentage will be -200%. As this is a negative value, it will not flag the Trading Party as being in Credit Default.

The Proposer of the Modification suggested three possible solutions to this:

- The definition of Credit Cover Percentage in Section M3.1.1 (a) be modified to take into account negative Credit Cover.
- The definition of Credit Cover could be modified to say that non payments should be deducted from the amount of credit lodged, provided the Credit Cover never become less than zero.
- The definition of Energy Indebtedness could be amended to reflect the amount of unpaid Trading Charges.

The Proposer believes that the Modification Group assigned to consider Modification Proposal P76 should decide upon the most appropriate solution to this issue. Until a solution is decided upon, the impact of this Modification cannot be accurately assessed.

However, any amendment to the definition of Credit Cover, Credit Cover Percentage or Energy Indebtedness may have a significant impact on ECVA and/or FAA. An amendment to the definition of Credit Cover could impact Trading Parties ability to balance their Credit Cover position over a period of days.

A copy of the Modification Proposal, as submitted by its proposer, can be found at Annex 1 to this report.

4 IMPACT ON BSC SYSTEMS AND PROCESSES

BSC System / Process	Potential Impact of Proposed Modification
Credit Checking	A potential impact on ECVAA depending on what solution is decided upon
Clearing, Invoicing and Payment	A potential impact on FAA could occur depending on what solution is decided upon

5 IMPACT ON OTHER SYSTEMS AND PROCESSES USED BY PARTIES

The solution may impact the ability of Parties to balance their Credit Cover, and therefore their Energy Indebtedness, over the period in question. It may also impact Parties verification of their own Energy Indebtedness.

6 IMPACT ON DOCUMENTATION

6.1 Impact on Balancing and Settlement Code

BSC Section	Potential Impact of Proposed Modification
M: Credit Cover and Credit Default	This section will need amending to reflect any amendments to the definition of Credit Cover Percentage, Credit Cover, or Energy Indebtedness.

6.2 Impact on Code Subsidiary Documents

Code Subsidiary Document	Potential Impact of Proposed Modification
BSC Service Descriptions	The FAA Service Description may have to be amended if they have to notify relevant Parties of a negative Energy Credit Cover.
Data Catalogues	Documentation may have to be amended to reflect that Credit Cover should never have a negative value.

7 IMPACT ON OTHER CONFIGURABLE ITEMS

The FAA User Requirement Specification and Working Practices may need to be amended. The ECVAA User Requirements Specification and Service Descriptions may also need amending.

8 IMPACT ON ELEXON

Area of Business	Potential Impact of Proposed Modification
ELEXON Procedures	There is a potential for improved effectiveness due to the availability of more accurate information

9 PROCESS AND TIMETABLE FOR PROGRESSING THE PROPOSAL

ELEXON recommends that Modification Proposal P76 be submitted to the Credit Modification Group for Assessment. The Credit Modification Group should be actioned to provide its report to the Panel by 18 July 2002.

It is expected that P76 will need three meetings during the Assessment Procedure.

The Modification Group will decide upon a solution in the first meeting on 23 April 2002. A draft Assessment Report and Requirement Specification will be produced which details the proposed solution and distributed for Industry consultation and High Level Impact Assessment. The Modification Group will meet on the 29 May 2002 and consider these responses and incorporate them into the agreed solution. The draft Assessment Report and Requirements Specification report will be updated and distributed to the Modification Group for approval. It is aimed to get approval for this document by 7 June 2002.

The approved Requirements Specification will be distributed to the applicable BSC Agents for Detailed Level Impact Assessment on 10 June.

The Modification Group will meet to consider the Impact Assessment on 1 July 2002 and the Assessment Report will be finalised. This will be issued to the Modification Group for approval and the finalised paper will be presented to the Panel on the 18 July 2002.

10 ISSUES

The following issues will need to be considered and addressed in progressing the Modification Proposal:

- Impact Assessments on the ECVA and FAA will need to be conducted once a final solution has been decided upon.
- The potential impact on Parties systems and processes will also need to be considered carefully.

ANNEX 1 – MODIFICATION PROPOSAL

Modification Proposal	MP No: 76 <i>(mandatory by BSCCo)</i>
Title of Modification Proposal <i>(mandatory by proposer):</i> Anomalies Associated With Negative Quantities Of Credit Cover	
Submission Date <i>(mandatory by proposer):</i> 08 April 2002	
<p style="text-align: center;">Description of Proposed Modification <i>(mandatory by proposer):</i></p> <p>This proposal seeks to address anomalies that arise in the Credit Cover calculation when unpaid Trading Charges cause a Party's Credit Cover to become negative.</p> <p>At present Section M2.1.3 of the Code defines the amount of a Trading Party's Credit Cover at any time as:</p> <p>(a) the sum of the maximum undrawn amount for the time being of any Letter of Credit delivered by it, and the principal amount of any cash paid by it and credited to the Reserve Account by the FAA on behalf of the BSC Clearer</p> <p>less</p> <p>(b) the sum of any amounts payable by the Trading Party in respect of Trading Charges which have become due for payment and have not been paid by the Trading Party on the relevant Payments Date in accordance with Section N, and remain unpaid at such time.</p> <p>Therefore if a Trading Party fails to pay any Trading Charges on the relevant Payment Date, the amount of non payment is deducted from the current level of Credit Cover by the Funds Administration Agent (FAA) and details of the new Credit Cover are sent to the Energy Contract Volume Aggregation Agent (ECVAA) for inclusion in the credit checking process.</p> <p>However if the amount of non payment is greater than the current Energy Credit Cover, then the result will be a negative Energy Credit Cover. This will distort the effect of the credit checking calculations. For example if a Trading Party's Energy Credit Cover is 100MWh and their Energy Indebtedness is 200MWh, their Credit Cover Percentage will be 200% and they will be in Credit Default. However if the Trading Party fails to pay Trading Charges equivalent to 200MWh then their Energy Credit Cover will become -100MWh. If the Energy Indebtedness stays the same, the Credit Cover Percentage will be -200%. As this is a negative value, it will not flag the Trading Party as being in Credit Default even though they no longer have enough Credit Cover to secure their outstanding Settlement liabilities.</p> <p>It is suggested that the definition of Credit Cover Percentage in Section M3.1.1. (a) be modified to take into account negative Credit Cover. Alternatively the definition of Credit Cover could be modified to say that non payments should be deducted from the amount of credit lodged, provided the Credit Cover never become less than zero. Another option would be to modify the definition of Energy Indebtedness to include the amount of unpaid Trading Charges.</p>	
<p>Description of Issue or Defect that Modification Proposal Seeks to Address <i>(mandatory by proposer):</i></p> <p>Section M2.1.3. introduces a link between the Payment Default procedure and the Credit Default procedure by taking non payment of Trading Charges into account when calculating the amount of Credit Cover available to each Trading Party. As the amount of non payment may be greater than the amount of Credit Cover lodged by a Trading Party, then it is possible for the Energy Credit Cover to be negative. However the credit checking process does not accurately reflect a Trading Party's indebtedness position when a negative Energy Credit Cover is used.</p> <p>We believe this modification proposal will reduce the bad debt risk faced by the industry. Under current</p>	

Modification Proposal	MP No: 76 <i>(mandatory by BSCCo)</i>
<p>arrangements a Party can continue notifying sales contracts and increasing its overall exposure to the industry until ECVNA authorisations are terminated by the Panel in accordance with Section H3.2 of the Code, which can ultimately be to the detriment of other Parties. This modification will allow the credit checking process to take into account occasions when the Trading Party has stopped paying Trading Charges and already has an unsecured debt.</p>	
<p>Impact on Code <i>(optional by proposer):</i> Section M will require modifying to reflect any amended definitions.</p>	
<p>Impact on Core Industry Documents <i>(optional by proposer):</i> N/A</p>	
<p>Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties <i>(optional by proposer):</i> The credit checking process within the ECVAA System may need changing if a modification to the calculation of Credit Cover Percentage is required.</p>	
<p>Impact on other Configurable Items <i>(optional by proposer):</i> N/A</p>	
<p>Justification for Proposed Modification with Reference to Applicable BSC Objectives <i>(mandatory by proposer):</i> We believe this modification proposal 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 as the overall credit risk faced by the industry would be reduced.</p>	
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Modification Proposal	MP No: 76 <i>(mandatory by BSCCo)</i>
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Attachments: NO If Yes, Title and No. of Pages of Each Attachment:	