20 July 2001

DEFINITION REPORT

MODIFICATION PROPOSAL P11 – Revision of the Minimum Credit Cover Requirements

Prepared by the Credit Modification Group on behalf of the Balancing and Settlement Code Panel

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Author	ELEXON

I DOCUMENT CONTROL

a Authorities

Version	Date	Author	Signature	Change Reference
0.1	21/06/01	ELEXON – Trading Strategy		
1.0	22/06/01	ELEXON – Trading Strategy		
2.0	20/7/01	ELEXON – Trading Strategy		

Version	Date	Reviewer	Signature	Responsibility
1.0	22/06/01	C. Rowell		P11 Modification Group Chairman
2.0	20/07/01	C. Rowell		P11 Modification Group Chairman

b Distribution

Name	Organisation
BSC Panel	

c Intellectual Property Rights and Copyright

II CONTENTS TABLE

1 SUMMARY AND RECOMMENDATIONS

1.1 Summary

Modification Proposal P11 was submitted on 9th May 2001 by The European Power Source Company (UK) Limited. The proposal seeks to revise the minimum credit cover requirements, in order to increase the likelihood that any Party defaulting on their Trading Charges would have sufficient credit cover in place, and hence reduce the risk of financial loss to other Trading Parties.

An Initial Assessment was undertaken and presented to the Panel. The Panel agreed that a Definition Procedure should be undertaken with respect to Modification Proposal P11 and, due to the interactions with Modification proposal P2, should be considered by the same Modification Group.

The Initial Written Assessment was issued for consultation and the responses to the consultation were discussed at the P11 Modification Group meeting on the 20th June 2001.

The majority of respondents to the consultation supported the proposed modification. The Modification Group's view was that, in principle, a Modification that obliged Parties to provide a level of credit cover higher than their actual indebtedness at any moment of time could better facilitate achievement of the BSC Objectives.

The Group felt that further detailed assessment was required to establish whether in fact this Modification did facilitate achievement of the BSC Objectives, or whether an Alternative Modification Proposal might better achieve this.

Version 1.0 of this Definition Report was presented to the BSC Panel at the meeting on the 28 June 2001. The BSC Panel decided that Modification P11 had not been defined in sufficient detail to enable a decision to be made and therefore the Definition Phase should be extended. The Modification Group met on the 13 July 2001 to discuss the Modification Proposal further. Due to the extension of the Definition Phase, the date for completion of the Assessment Report was delayed until September 2001

1.2 Recommendation

On the basis of the analysis, consultation and assessment undertaken in respect of this Modification Proposal during the Definition Phase, and the resultant findings of this report, the Modification Group recommends that the:

1) **The Proposal should be submitted to the Assessment Procedure;**
2) **The Modifications Group should consult with Parties on the proposal, on the matters including setting a de minimis level of cover and its effects on new entrants; and**
3) **The Assessment Procedure should be completed to enable a report to be presented to the Panel on 20th September 2001.**

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 PURPOSE AND SCOPE OF THE REPORT

BSC Section F sets out the procedures for progressing proposals to amend the BSC (known as 'Modification Proposals'. These include procedures for proposing, consulting on, developing, evaluating and reporting to the Authority on potential modifications.

The BSC Panel is charged with supervising and implementing the modification procedures. ELEXON provides the secretariat and other advice, support and resource required by the Panel for this purpose. In addition, if a modification to the Code is approved or directed by the Authority, ELEXON is responsible for overseeing the implementation of that amendment (including any consequential changes to systems, procedures and documentation).

The Panel may decide to submit a Modification Proposal to the 'Definition Procedure'[1]. In such cases, the Panel commissions a Modification Group to define the issues raised by a Modification Proposal in sufficient detail to enable the Panel to determine whether to:

a) Refer the proposal back to the Modification Group for further analysis; or

b) Submit the proposal to the Assessment Procedure[2]; or

c) Proceed directly to the Report Phase[3].

The Modification Group is therefore tasked with reviewing the Modification Proposal with a view to providing clarification and definition where there is insufficient detail in the proposal to allow the Panel to decide whether to proceed with a detailed evaluation. The Modification Group must prepare a written report for the Panel that sets out the following matters[4]:

a) An assessment of the issues raised by the Modification Proposal with supporting information and data to explain the effect of such issues by reference to the Applicable BSC Objective(s)[5] and a summary of such assessment;

b) An analysis of and the views and rationale of the Modification Group as to whether (and, if so, to what extent) the issues raised by the Modification Proposal warrant further assessment and evaluation under the Assessment Procedure;

c) A detailed summary of the representations made by Parties and interested third parties during any consultation undertaken by the Modification Group and the comments and views of the Modification Group in respect thereof;

d) A summary of any analysis prepared by the Transmission Company and the comments and views of the Modification Group in respect thereof;

e) A summary of the analysis prepared by relevant BSC Agents and the comments and views of the Modification Group in respect thereof;

f) Where applicable, a copy of the terms of reference and a summary of any report or analysis of external consultants or advisers; and

g) Such other matters as the Panel may require in the terms of reference of the relevant Modification Group.

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[1] See BSC F2.5
[2] See BSC F2.6
[3] See BSC F2.7
[4] See BSC F2.5.4
[5] As defined in the Transmission Licence

This Definition Report seeks to address all of the above items to the extent relevant to the Modification Proposal in question.

4 MODIFICATION GROUP DETAILS

This Definition Report has been prepared by the Credit Modification Group. The Membership of the Modification Group was as follows:

No.	Member	Organisation
1.	Gavin Ferguson/ Catherine McNally* #	British Gas Trading
2.	Andrew Foster/Xavier Bruckert	OM London Exchange
3.	Libby Glazebrook	Edison Mission Energy
4.	Ben Willis* #	Yorkshire Electricity
5.	Sharif Islam	TotalFinaElf
6.	Duncan Jack #	St Clements
7.	Bruno Plaskow	Innogy
8.	Fiona Grandison*/ Broustas Marios* #	The European Power Source Company ((UK) Ltd) (Proposer)
9.	Richard Lavender* #	Transmission Company
10.	Nick Simpson/Sonia Brown	Ofgem

* Indicates those members present at the first meeting of the Modification Group on 20 June 2001.

# Indicates those members present at the second meeting of the Modification Group on 13 July 2001

In addition to the members present, the following people attended the first meeting of the Modification Group.

No.	Attendee	Organisation
11.	Chris Rowell	ELEXON (Chairman)
12.	Christoper Price	Powergen
13.	Martyn Hunter	St. Clements Services
14.	Richard Haigh	ELEXON
15.	Lisa Hughes	Ofgem
16.	Ayesha Uvais	Ofgem
17.	Robert Barnett	Campbell Carr
18.	Richard Clarke	ELEXON
19.	John Lucas	ELEXON

In addition to the members present, the following people attended the second meeting of the Modification Group.

No.	Attendee	Organisation
20.	Chris Rowell	ELEXON (Chairman)
21.	Robert Barnett	Campbell Carr
22.	John Lucas	ELEXON
23.	Sarah Parsons	ELEXON
24.	Steve Francis	ELEXON

5 THE NEED FOR FURTHER ASSESSMENT AND EVALUATION

The recommendation of the Modification Group is that the Modification Proposal is submitted to the Assessment Phase. This decision was taken in light of majority of the responses received from BSC Parties that favoured the implementation of some form of minimum Credit Cover arrangements.

Should the Modification Proposal be submitted to the Assessment Phase, the Modification Group will need to consider the following:

a) Assess the costs of implementing the Modification Proposal, in terms of amendments to BSC Agents systems and BSC Party systems.

b) Assess the timescales required to implement the Modification Proposal.

c) Consider whether any of the Alternative Modification Proposals would better facilitate the achievement of the BSC Objectives.

6 REPRESENTATIONS BY PARTIES AND INTERESTED THIRD PARTIES

6.1 Summary of Representations

Of the nine responses received, the majority supported the principle of reviewing minimum credit cover provisions under the BSC. Several of these respondents, however, expressed concern over the minimum level that may be set following the implementation of this Modification Proposal.

A number of respondents implied the detail of P11 might discriminate against the smaller players or act as a barrier to market entry.

Two respondents suggested it would be necessary to consider seasonal factors when setting the minimum level of credit cover required.

One respondent believed the use of historical data to be inappropriate due to anomalies that may have existing at market start-up.

One respondent indicated that they were unable to support the Modification Proposal unless they had a clear understanding of the level that was proposed.

One respondent questioned whether there would be a mechanism that would allow a Trading Party a right of appeal against the minimum level of Credit Cover.

Several responses emphasised the interdependency between P2 and P11.

One respondent suggested that ELEXON determine the minimum levels of credit cover whilst the Energy Contract Volume Aggregation Agent (ECVAA) should monitor Trading Parties against this level.

One respondent indicated that sanctions against participants should not be the same as the general provisions regarding default as this would be more of a deterrent. This respondent went further in suggesting that such sanctions should be discussed as part of an assessment procedure.

Copies of all representations are attached in Annex 1

6.2 Comments and Views of the Modification Group

The Modification Group noted the responses from the consultation on the Initial Written Assessment. In particular the Group noted that respondents were in the main receptive to the proposal.

The Modification Group noted that there was a significant dependency between Modification Proposal P11 and Modification Proposal P2 and that any implementation of P11 would be likely to depend on the solution for P2.

Discussion in the Modification Group in relation to P11 focussed on three areas as follows:

a) Clarification of the Modification Proposal itself.

b) What reasons there were to change the BSC in order to introduce a minimum credit cover requirement and/or a requirement to maintain credit cover within a specified percentage of historic Energy Indebtedness.

c) Given the above reasons, what would be the appropriate form of any such obligation.

6.2.1 Clarification of Modification Proposal

Modification Proposal P11 proposes to introduce a minimum level of Credit Cover for all Trading Parties. This differs from the current credit methodology, which allows Trading Parties to determine how much Credit Cover they wish to lodge. Under the current arrangements a Trading Party can choose to have zero Credit Cover if they believe they will never have a positive Energy Indebtedness, as calculated by the ECVAA.

It has been proposed that ELEXON, or an appropriate Third Party should determine the minimum level of Credit Cover. The Credit Cover would be based on the larger of (1) a predetermined GBP value, or (2) a specified level of Energy Indebtedness for each Trading Party that would be based on the assessment of that party's Energy Indebtedness over the previous 12 months.

The Proposer further defined the predetermined value to be £50,000. This level of Credit Cover will be the minimum for new Trading Parties that have no historical Energy Indebtedness data. The Modification Group recommends that if the Modification Proposal were referred to Assessment Phase, further analysis should be carried out to see whether a flat £50,000 is an appropriate level, and if not, what level would be more appropriate.

The following process will thereafter be used:

- A historical period over which the minimum credit cover level is to be derived will be defined. This would normally be a period of one calendar year, but could be less if for example the Trading Party was a recent entrant to the market, and a year's data was not available.
- Values of Energy Indebtedness (EI_{pj}) for the last Settlement Period of each Settlement Day in the historical period will be obtained, and sorted into decreasing order. Note that each of these values represents the total indebtedness (as calculated by the credit checking process) over a 29-day window.
- The (n + 1)th value in the list will be selected, where n is defined as the number of Settlement Days in the period multiplied by 5%, and rounded up to the nearest integer. (This means that, if the period is a whole year, the 20^{th} highest value of Energy Indebtedness is picked).

The Modification Group proposes that if the Modification Proposal is referred to Assessment Phase, they would analyse an Alternative Modification Proposal based on using actual cashflows taken from the Initial Settlement (SF) run, rather than the Energy Indebtedness values calculated by ECVAA. This would remove the inaccuracies associated with using a calculated value of Energy Indebtedness and the Credit Assesment Price, based on estimates of metered data and cashout prices.

Finally the Proposer confirmed that all new Trading Parties would be required to lodge the minimum level of Credit Cover before they would be allowed to start trading. Trading Parties who are already trading would need to ensure that their Credit Cover does not drop below the minimum level. If a Trading Party's calculated minimum level exceeds their actual credit cover, they will be given notice advising them to lodge more credit. Should a party fail to increase their Credit Cover following such a notice, they will be blocked from continuing to trade. It is envisaged that this defaulting procedure would mirror the Level 2 Credit Default process, where Volume Notifications, which increase indebtedness will be refused or rejected by the ECVAA.

The Modification Group suggests that if the Modification Proposal were to be referred to Assessment Phase, other methods of enforcing the proposal should be analysed. One alternative would be to ensure all Trading Parties lodge the minimum level of Credit Cover before they commence trading. However, if the minimum level exceeds their current level of Credit Cover, they will be allowed to continue trading, as their Energy Indebtedness (%) may still be significantly less than 80%. Should they breach the 80 or 90% level, the usual Credit Default procedures will be followed. In the majority of cases this will lead to the Trading Party lodging more credit and therefore having more than the minimum level of Credit Cover. Under this alternative, the Trading Party would not be allowed to reduce their Credit Cover below the minimum level in the future. This assumes that the current Level 1 and Level 2 Credit Default processes are robust enough to highlight any party that poses a potential risk of defaulting with outstanding settlement liabilities.

6.2.2 Objective of Modification Proposal

Further clarification of the objective of the obligation as submitted in the Modification Proposal was sought from the representative of the proposer of the Modification present at the Modifications Group Meeting of 20th June 2001. The representative of the proposer identified the following objectives:

1) Reduce Risk of Trading Parties Defaulting with Outstanding Settlement Liabilities

The proposer felt that the Modification Proposal would increase the likelihood of a Trading Party's Credit Cover being adequate relative to their trading activity. Under the current arrangements, Trading Parties may trade with zero credit cover. If such a Trading Party incurs Trading Charges then there is a potential risk of that party defaulting with outstanding settlement liabilities. Costs relating to such default would be borne by the rest of the market.

2) *Stability of Ongoing Trading under the BSC*

The proposer's representative felt that where a Trading Party defaults under the BSC, the market would suffer a crisis of confidence. Having a minimum level of Credit Cover, which all Trading Parties should maintain, would introduce a safeguard and thereby instil the additional confidence in the market. This should therefore have the effect of increasing competition in the market.

3) Third Party Oversight of Credit Cover Arrangements

The proposer's representative felt that the Electricity Market should adopt role of an independent overviewer that is contained within more mature trading markets. The role of a third party to ensure that a minimum level of credit cover was lodged would in their view be consistent with arrangements in typical traded markets.

4) Minimise Frequency of Credit Default

The proposer's representative felt that this proposal, if implemented, would decrease the number of Level 1 and Level 2 Credit Defaults.

A number of other reasons as to why it may be appropriate to consider implementing a minimum credit cover provision (i.e. £ value), or to increase the quantity of credit cover (in percentage terms) were discussed in the Modification Group Meetings. The possible objectives identified were:

1) Credit Cover in Query Period

The Modification Group noted that there was an in-built delay in the credit checking provisions within Section M of the Code. Prior to the commencement of refusal and rejection of notifications for credit reasons, it was necessary to wait until the expiry of the Query Period. The Modifications Group believed that there may be some merit in considering whether some additional credit cover provisions should be included in order to provide for the possibility of a defaulting party increasing its indebtedness further during the Query Period.

2) Interaction with Modification Proposal P2

The Modification Group noted that by setting appropriate values of CAP, it was possible under the existing arrangements to bias the quantity of credit cover required to be provided by a party as a proportion of its calculated Energy Indebtedness over the 29-30 day credit period. Were Modification Proposal P2 to be implemented, it was likely that the use of CAP would be limited to (approximately) 7 days out of the 29-30 days in the credit period. Thus if it were decided that it was appropriate to bias the credit cover required to be provided based on a percentage of aggregate Energy Indebtedness over the entire credit cover period following the implementation of P2, an additional change to the provisions would be needed to achieve this.

3) Cost benefit analysis

The Modifications Group noted that any mechanism that involves estimated indebtedness, would necessarily be incorrect to a certain extent. Thus it could be expected that at any time there would be a distribution in the errors of indebtedness (i.e. the difference between the estimated indebtedness and the actual indebtedness). Biasing the requirement to provide credit cover would shift this distribution. For example if parties were required to provide twice as much credit cover as the estimate of their indebtedness, then the probability that parties were under-providing credit would decrease. The Modifications Group believed that in theory, it may be desirable to deliberately bias the credit cover requirements so as to minimise the overall ‘cost’ to the industry. If the credit requirements were overstated, then clearly the cost of providing credit would increase. Balanced against this, was the fact that the probability of a defaulting party doing so with insufficient credit cover was reduced. Hence the likely ‘bad debt’ burden was reduced. Whether or not it was desirable to bias arrangements so as to deliberately overstate credit requirements or to deliberately understate them, may depend on the relative costs of providing cover, and the probability of bad debts arising.

The Proposer confirmed that the Modification Proposal was not intended to extend the scope of Credit Cover to include post-default debt.

In light of the above discussion, the Modification Group believed that it would be appropriate to recommend to the Panel that Modification Proposal P11 be submitted to Assessment, so that the objective of the Modification, the interaction with BSC Objectives and the appropriate implementation options could be further considered.

It should be noted that one attendee at the Modification Group meeting on the 13 July 2001 recommended submitting the Modification Proposal straight to the Report Phase, with the aim of rejecting the proposal. This recommendation was based on the view that the Modification Proposal would increase the amount of Credit Cover required with no visible advantage to BSC Parties. This would therefore discriminate against smaller players or act as a barrier to market entry which fails to promote ‘effective competition in the generation and supply of electricity’, the BSC objective under condition 7A(3) (c) of the transmission licence. A minority of consultation responses supported this view.

ANNEX 1 – MODIFICATION PROPOSAL P11

Modification Proposal	**MP No: 11** *(mandatory by BSCCo)*

Title of Modification Proposal *(mandatory by proposer)***:**

Revision Of Minimum Credit Cover Requirements

Submission Date *(mandatory by proposer)***:** 09 May 2001

Description of Proposed Modification *(mandatory by proposer)***:**

The European Power Source Company (U.K.) Limited propose: the introduction of a minimum credit requirement for Trading Parties based on historical Energy Indebtedness (EI) levels. This proposal would not impact the default procedures (i.e., Level 1/Level 2) described in Section M.

According to this proposal, Trading Parties would be required to maintain a minimum level of Energy Credit Cover (ECC) in order to be able to transact. The minimum ECC required would be determined by ELEXON, or an appropriate third party, and would be based on the larger of (1) a predetermined GBP value or (2) a specified level of EI for each Trading Party that would be based on an assessment of that party's EI over the previous 12 months. For example, the minimum ECC calculated in (2) could be equal to the 20th highest level of EI reached in any one day over the preceeding 12 months. (This is roughly equivalent to a 95th percentile worst case level of EI.)

Minimum ECC levels would be rexamined by ELEXON, or another appropriate third party, at least each time a Trading Party has reached Level 2 Credit Default. Until 12 months of data is available, the minimum ECC level would be based on whatever data is available and would be reexamined at least each time a Trading Party has reached Level 1 or Level 2 Credit Default. Ideally, systems would be developed so that the minimum ECC level could be compared to historical EI on a daily basis.

Description of Issue or Defect that Modification Proposal Seeks to Address *(mandatory by proposer)***:**

Under the current credit arrangements provided by Section M, Trading Parties are expected to project their expected consumption and production volumes and post sufficient collateral with ELEXON to cover their projected EI level. This collateral then translates directly into the amount of ECC posted by that trading party. There is currently limited third-party oversight of the appropriateness of the ECC posted by Trading Parties.

In particular, a Trading Party could sets its own ECC limit at zero and attempt to remain in balance at the end of each settlement period. As a result, a Trading Party could accrue EI on the system without ever having posted collateral.

This proposal aims to modify the existing credit requirements so that Trading Parties are as fully protected as possible against EI that could arise due to the action of any one Trading Party by requiring a reasonable level of up-front collateral that, wherever possible, is based on historical trading data.

Impact on Code *(optional by proposer)***:**

This proposal could result in several revisions to Section M.

Impact on Core Industry Documents *(optional by proposer)***:**

No impact envisioned at this time.

Modification Proposal	**MP No: 11** *(mandatory by BSCCo)*

Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties *(optional by proposer)***:**

Systems requirements for BSC and/or ELEXON to be explored. No additional system requirements envisioned for signatories to the BSC.

Impact on other Configurable Items *(optional by proposer)***:**

Justification for Proposed Modification with Reference to Applicable BSC Objectives *(mandatory by proposer)***:**

This proposal seeks to take advantage of the growing amount of trading data as it becomes available to further strengthen the BSC's existing credit requirements. In concept, this proposal aims to to protect Trading Parties as fully as possible and facilitate trading by (1) setting minimum credit requirements for Trading Parties participating in the BSC, (2) minimising the frequency of Level 1 and Level 2 default and (3) ensuring that Trading Parties have limited exposure to liabilities arising from failure of other Trading Parties to cover their own EI.

Specifically, this Modification Proposal will assist in achieving the BSC Objective specified in Section B 1.2.1 (b)(ii) of achieving "an efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System"; and the objective specified in Paragraph 7A (3)(d) of the Transmission Licence, namely "promoting efficiency in the implementation and administration of the balancing and settlement arrangements."

Details of Proposer:

Name: Marios V. Broustas

Organisation: The European Power Source Company (UK) Limited

Telephone Number: +44-20-7774-0083

Email Address: marios.broustas@gs.com

Details of Proposer's Representative:

Name: Marios V. Broustas

Organisation: The European Power Source Company (UK) Limited

Telephone Number: +44-20-7774-0083

Email Address: marios.broustas@gs.com

Details of Representative's Alternate:

Name: Fiona Grandison

Organisation: The European Power Source Company (UK) Limited

Telephone Number: +44 20 7774 1343

Email Address: fiona.grandison@gs.com

Modification Proposal	**MP No: 11** *(mandatory by BSCCo)*
Attachments: NO **If Yes, Title and No. of Pages of Each Attachment:**	

ANNEX 2 - REPRESENTATIONS MADE BY PARTIES

No	Company	File Number	For	Against	Other
1.	European Power Source Company (U.K.) Limited	P11_DEF_001	✓		
2.	London Electricity	P11_DEF_002	✓		Suggests alternative modification
3.	SEEBOARD	P11_DEF_003	✓		But contingent on outcome of P2
4.	Northern Electric	P11_DEF_004			Not certain about proposal, but supports review of the minimum credit cover requirements
5.	Aquila	P11_DEF_005		✓	But supports principle. Would like to see an alternative mod.
6.	ScottishPower	P11_DEF_006	✓		
7.	Scottish & Southern	P11_DEF_007	✓		Support principle, but further analysis required
8.	Yorkshire Electricity	P11_DEF_008		✓	
9.	Powergen	P11_DEF_009	✓		Impact on participants needed

P11_DEF_001: European Power Source Company (U.K.) Limited

From: Broustas, Marios[SMTP:marios.broustas@gs.com]
Sent: 07 June 2001 09:23
To: 'modifications@elexon.co.uk'
Cc: Grandison, Fiona
Subject: Modification Proposal P11

The European Power Source Company (U.K.) Limited supports Modification Proposal P11.

Regards,

Marios Broustas
Credit Risk Management
The European Power Source Company (U.K.) Limited

P11_DEF_002: London Electricity

From: Walker Rachel[SMTP:Rachel_Walker@londonelec.co.uk]
Sent: 08 June 2001 11:53
To: 'modifications@elexon.co.uk'
Subject: P11 Definition Comments

Please find London Electricity's comments on modification P11 below.

London Electricity is generally supportive of Modification Proposal 11, as it will reassure participants that there is a reasonable amount of cover available should another party go into default. Although many participants, including London Electricity, have sufficient credit cover to cover their active participation in the Balancing Market, it is possible that those who are new to the market or do not intend to trade in the BM may inadvertently obtain an imbalance position. To oblige every party to lodge credit cover would reduce party risks and so would help to promote 'effective competition in the generation and supply of electricity', the BSC objective under Condition 7A(3)(c) of the transmission licence.

This modification is rightly being aligned with P2 as they cover related areas.

Monitoring of this function should probably be performed by the ECVAA under its current credit-monitoring role. We do not feel that sanctions against participants should be the same as the general provisions regarding default as this will be no more of a deterrent. They should be investigated and discussed in the Assessment Procedure.

It should be ensured that the minimum level of credit to be posted should not be punitive on any party, specifically smaller players as this could inhibit competition. It has been suggested that the minimum level should be either a fixed amount or the 20th highest level of Energy Indebtedness in a year. An alternative would be to take an estimate of annual volume from the new entrants' business plans submitted to obtain their Licence and assume they have an imbalance of 5 or 10%. This subject of minimum credit deposits should also be explored during the Assessment Procedure.

Regards

Rachel Walker

P11_DEF_003: SEEBOARD

From: Fraser, Sue[SMTP:SFraser@seeboard.com]
Sent: 08 June 2001 14:07
To: 'modifications@elexon.co.uk'
Subject: P11 Definition Comment - SEEBOARD's response

Seeboard's response is as follows:-

The most important issue is that Elexon recognise the interaction of P11 with P2 and we would ask them to ensure both be reviewed by the same Modification group and to the same timetable. We strongly support Elexon's approach. The outcome of the review of P2 would certainly impact any potential minimum credit requirements proposed by modification P11.

We would generally support the principle of minimum credit limits, however a sensible mechanism for setting that level would have to be determined. It would be important not to create a significant barrier to entry.

Sue Fraser
for DAVE MORTON
0190 328 3465

P11_DEF_004: Northern Electric

8th June 2001

Modification Department
ELEXON
10th Floor
338 Euston Road
London
NW1 3BP

Dear Sir

Modification Proposal P11: Revision of Minimum Credit Cover Requirements

Northern Electric and Gas welcomes the opportunity to provide comments on modification P11: Revision of Minimum Credit Cover Requirements.

We support a review of the minimum credit cover requirements under the Balancing and Settlement Code (BSC) in order to assess whether the current provisions meet the Code's relevant objectives. We are not certain at this stage whether Modification P11 will better fulfil the Code objectives. We do, however, believe that provisions are required to protect the market with respect to exposure of market participants to trading parties that have insufficient credit cover or who may be in a process of default.

An enduring approach to minimum credit cover level is required which is transparent, non-discriminatory and efficient for all market participants. We believe that in defining the modification that the following criteria should be used:

* Whether the proposal introduces any market distortions (i.e. favours larger players at the expense of smaller players or vice versa);
* Whether seasonal effects of energy indebtedness should be or could be taken into account in calculating minimum credit cover requirements (perhaps in relation to Demand Capacity and Generation Capacity values submitted in accordance with section 3.4 of the Code); and
* The extent to which the provisions are robust in circumstances where a trading party is experiencing financial difficulties.

We note that Modification P11 is being submitted to a Modification Group under the definition procedure as section F2.5 of the BSC and we look forward to the outcome of the deliberations of this Group.

We hope that these comments are helpful,

Yours faithfully

Trevor Wills
Energy Analyst
Northern Electric and Gas
Northern Electric and Gas

P11_DEF_005: Aquila

Aquila
Southside
105 Victoria Street
London
SW1E 6QT

08 June 2001

Dear Sirs,

MP11: Revision of Minimum Credit Cover Requirements

Aquila does not think that this modification should be implemented, although we are supportive of some of the principles that lie behind it.

The current arrangements, which rely on projected consumption and production volumes, are not ideal and should be reformed once players have a credit history to evaluate. There may be a case for waiting until NETA has been up and running 12 months before moving to a credit cover requirement that looks at the previous 12 months.

Aquila is not opposed to the principle of applying a "greater of" rule in respect to a cash sum and observed credit history, but the exact value of the minimum cash value required as credit cover is all-important. Aquila would prefer to see a modification proposal that puts forward a definite "minimum" figure (or at least a formula for its calculation) for the community to comment upon.

Yours sincerely,

Alastair Johnston
Analyst, Legal & Regulatory Affairs

P11_DEF_006: ScottishPower

Cathcart Business Park, Spean Street
Cathcart, Glasgow, G44 4BE
Telephone (0141) 568 2313
FAX (0141) 568 2366

8th June 2001

Gareth Forrester
Modifications Manager
ELEXON Ltd
3rd Floor
1 Triton Square
London
NW1 3DX

Modification Proposal P11 Comments

Dear Mr Forrester,

ScottishPower supports the intention of this Modification Proposal: to provide a level of credit cover that increases the likelihood that any trading party defaulting would have sufficient credit cover in place to cover their settlement liabilities, and therefore reduce the risk of financial loss to other trading parties. The proposal would also serve to minimise the frequency of exposure to level 1 and level 2 defaults.

ScottishPower believes that by reducing party risks this modification will ensure that all trading parties can operate in a stable environment and are not threatened by the default of another party who at the time of default has trading charges in excess of their credit cover. This modification serves to mitigate trading parties exposure to liabilities from other trading party default, and hence is in line with the applicable BSC objectives.

ScottishPower supports the proposal that the credit level is calculated on historical trading rather than the trading party's own view of their ability to balance at the end of the settlement period. The present arrangement allows a trading party to set energy credit cover limit at zero. Especially as it is recognised there is currently limited third party oversight of the approriateness of the credit cover we should move to a system based on actual data rather than trading party's view/forecast.

I hope you find these comments helpful and please do not hesitate to contact me if you wish to discuss them further.

Regards,
Steve Field

P11_DEF_007: Scottish and Southern Energy

From: Robert Hackland[SMTP:Robert.Hackland@scottish-southern.co.uk]
Sent: 08 June 2001 16:49
To: Modifications@elexon.co.uk
Subject: Modification Proposal P11

Below are Scottish and Southern Energy's comments on Modification Proposal P11 - Minimum Credit Cover Requirements

Modification Proposal P11 - Minimum Credit Cover Requirements

Introduction

Scottish and Southern Energy agree with the principle of this modification. We believe the introduction of a minimum credit cover requirement to ensure that any Party in default has sufficient credit cover in place to reduce the financial exposure of other Trading Parties is consistent with the BSC
objectives. We believe that such a modification would increase the efficiency of current balancing and settlement arrangements and promote competition in generation and supply. We believe that any associated increase in cost would be outweighed by the benefits as mentioned above but are agree that further analysis is required to quantify these benefits and costs. We also believe that
further work is required to establish an appropriate mechanism for determining and implementing appropriate minimum credit requirements and assessing the impact on systems and participants more generally.

Administration of Minimum Credit Cover Requirements

It seems appropriate that Elexon should determine the minimum ECC required and that monitoring should rest with the ECVAA as an extension to their existing role in relation to credit requirements. However we believe that further consideration should be given to the practicalities of this arrangements. It is essential that appropriate sanctions are introduced to ensure that participants
adhere to the requirements. Our initial view is that existing provisions should be sufficient but once again support further analysis.

Calculation of Minimum Credit Cover Requirements

In principle we agree that minimum credit cover requirements should relate to previous energy indebtedness say over the previous 12 months or whatever period is available. However we believe further consideration is required as to:

- whether a 95th percentile value is appropriate
- whether seasonal variations in minimum credit cover requirements would be appropriate and
- whether there should be a right of appeal or amendment should trading activities change significantly.

Modification P2 - Revision of the Methodology for Assessing Credit Indebtedness

We believe these modifications are inextricably linked and support the move to ensure that they are considered in parallel.

Regards

Robert Hackland

P11_DEF_008: Yorkshire Electricity

From:
Andrew.Wrigglesworth@yeg.co.uk[SMTP:Andrew.Wrigglesworth@yeg.co.uk]
Sent: 08 June 2001 17:02
To: modifications@elexon.co.uk
Cc: ben.willis@yeg.co.uk
Subject: Modification P11 response sent on behalf of Ben Willis (due to e-mail difficulties)
Importance: High

Yorkshire Electricity do not support this modification, since basing minimum requirement on historic performance currently incorporates Go Live, when many companies were operating in exceptional circumstance, which hopefully will not be repeated in the future. This time is not representative of normal trading, and would lead to penal credit requirements being enforced. This is not in line with Objectives (b) and(d) of the Balancing and Settlement Code.

Thank you

Ben Willis
Representation Co-ordinator
Yorkshire Electricity

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Development manager

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P11_DEF_009 – Powergen

16 May 2001
John Lucas
P11 Modification Group

Dear John

Modification Proposal P11 - Revision of Minimum Credit Cover

Thank you for giving us the opportunity to make some initial comments on this proposal.

In principle Powergen believes that it would be prudent to introduce minimum levels of credit cover based on past levels of indebtedness. This will limit the level of exposure faced by the industry should a BM participant get into financial difficulties. It is also likely to be complementary to Modification proposal P2, Revision of the methodology for credit indebtedness. Nevertheless we would like to fully understand how exactly the proposal might impact on BM participants, which for reasons outside their control, mat face occasional large (but atypical) imbalances. The proposal seems to deal with this by basing the minimum credit cover on the twentieth highest imbalance of a BM participant in the last 12 months. This may be reasonable but how would an appropriate value be set for new entrants?

There is a very real possibility that the chain of events that unfolds should a BM participant get into financial difficulties will result in significant imbalances which may ultimately remain unpaid. Although under the current rules a player is prevented from notifying further trades that will increase his indebtedness once the he reaches 90% of his Credit Cover, there is nothing that prevents withdrawal of existing notifications. Such withdrawal might be as a result of termination of a GTMA with a counter-party because of non-payment under that agreement.

Minimum levels of credit cover based on past 'high' imbalance levels will to some extent limit the potential exposure of the industry under the BSC in the case of business failure. In so doing we believe this proposal will better facilitate the BSC Applicable Objectives of achieving "an efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System" and "promoting efficiency in the implementation and administration of the balancing and settlement arrangements".

This proposal is a measured and prudent approach to ensuring both appropriate and adequate levels of credit cover are held by BM participants and that such cover is commensurate with the level and riskiness of the activities pursued by such companies. Such minimum standards do not, in our view, represent a barrier to entry. Smeared costs from unpaid imbalance charges only add to the costs of the remaining BM participants, which in the end are ultimately borne by customers.

We welcome further consideration of this proposal at the assessment stage.

Yours sincerely

Peter Bolitho
Head of Modifications
Powergen UK plc

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