



Draft MODIFICATION REPORT for Modification Proposal P158 Introducing the Ability to Lodge a Consolidated Letter of Credit

Prepared by: ELEXON on behalf of the Balancing and Settlement Code Panel (the 'Panel')

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This document has been distributed in accordance with Section F2.1.10¹ of the Balancing and Settlement Code.

RECOMMENDATIONS

Having considered and taken into due account the contents of draft P158 Modification Report, the Balancing and Settlement Code Panel recommends:

- **that Proposed Modification P158 should not be made;**
- **the P158 Implementation Date of 3 November 2004 if an Authority decision is received on or before 30 July 2004, or 23 February 2005 should an Authority decision be received after that date but before 12 November 2004; and**
- **the proposed text for modifying the Code, as set out in the draft Modification Report.**

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¹ The current version of the Balancing and Settlement Code (the 'Code') can be found at www.elexon.co.uk/ta/bscres_docs/bsc_code.html

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SUMMARY OF IMPACTED PARTIES AND DOCUMENTS

The following parties/documents have been identified as being potentially impacted by Modification Proposal P158.

Parties	Sections of the BSC	Code Subsidiary Documents
Suppliers <input checked="" type="checkbox"/>	A <input type="checkbox"/>	BSC Procedures <input checked="" type="checkbox"/>
Generators <input checked="" type="checkbox"/>	B <input type="checkbox"/>	Codes of Practice <input type="checkbox"/>
Licence Exemptable Generators <input checked="" type="checkbox"/>	C <input type="checkbox"/>	BSC Service Descriptions <input checked="" type="checkbox"/>
Transmission Company <input checked="" type="checkbox"/>	D <input type="checkbox"/>	Service Lines <input type="checkbox"/>
Interconnector <input checked="" type="checkbox"/>	E <input type="checkbox"/>	Data Catalogues <input type="checkbox"/>
Distribution System Operators <input type="checkbox"/>	F <input type="checkbox"/>	Communication Requirements Documents <input type="checkbox"/>
Party Agents		
Data Aggregators <input type="checkbox"/>	G <input type="checkbox"/>	Reporting Catalogue <input type="checkbox"/>
Data Collectors <input type="checkbox"/>	H <input type="checkbox"/>	MIDS <input type="checkbox"/>
Meter Operator Agents <input type="checkbox"/>	J <input type="checkbox"/>	Core Industry Documents
ECVNA <input type="checkbox"/>	K <input type="checkbox"/>	Grid Code <input type="checkbox"/>
MVRNA <input type="checkbox"/>	L <input type="checkbox"/>	Supplemental Agreements <input type="checkbox"/>
BSC Agents		
SAA <input type="checkbox"/>	M <input checked="" type="checkbox"/>	Ancillary Services Agreements <input type="checkbox"/>
FAA <input checked="" type="checkbox"/>	N <input checked="" type="checkbox"/>	Master Registration Agreement <input type="checkbox"/>
BMRA <input type="checkbox"/>	O <input type="checkbox"/>	Data Transfer Services Agreement <input type="checkbox"/>
ECVAA <input type="checkbox"/>	P <input type="checkbox"/>	British Grid Systems Agreement <input type="checkbox"/>
CDCA <input type="checkbox"/>	Q <input type="checkbox"/>	Use of Interconnector Agreement <input type="checkbox"/>
TAA <input type="checkbox"/>	R <input type="checkbox"/>	Settlement Agreement for Scotland <input type="checkbox"/>
CRA <input type="checkbox"/>	S <input type="checkbox"/>	Distribution Codes <input type="checkbox"/>
Teleswitch Agent <input type="checkbox"/>	T <input type="checkbox"/>	Distribution Use of System Agreements <input type="checkbox"/>
SVAA <input type="checkbox"/>	U <input type="checkbox"/>	Distribution Connection Agreements <input type="checkbox"/>
BSC Auditor <input type="checkbox"/>	V <input type="checkbox"/>	BSCCo
Profile Administrator <input type="checkbox"/>	W <input type="checkbox"/>	Internal Working Procedures <input checked="" type="checkbox"/>
Certification Agent <input type="checkbox"/>	X <input checked="" type="checkbox"/>	Other Documents
MIDP <input type="checkbox"/>		Transmission Licence <input type="checkbox"/>
TLFA <input type="checkbox"/>		
Other Agents		
SMRA <input type="checkbox"/>		
Data Transmission Provider <input type="checkbox"/>		

X = Identified in Report for last Procedure
 N = Newly identified in this Report

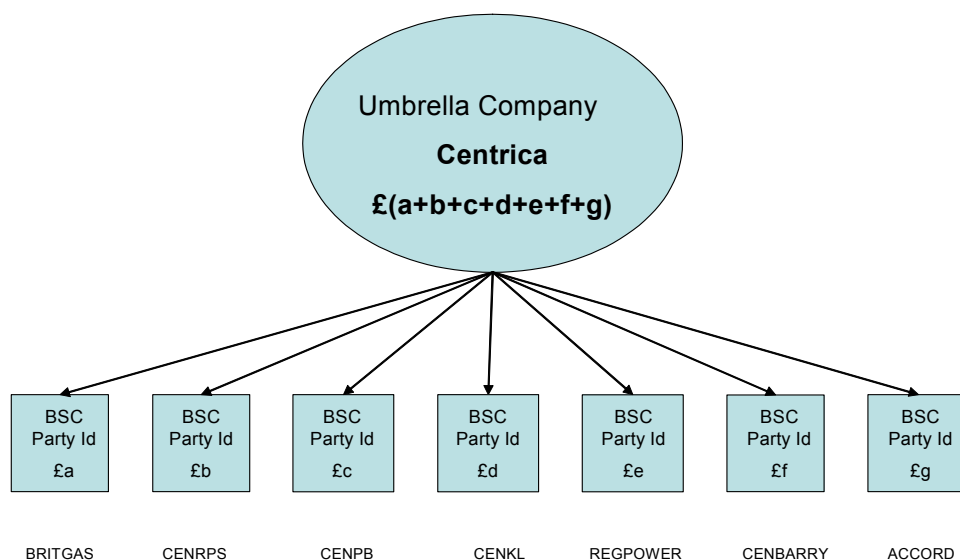
1 DESCRIPTION OF PROPOSED MODIFICATION AND ASSESSMENT AGAINST THE APPLICABLE BSC OBJECTIVES

1.1 Modification Proposal

Modification Proposal P158 'Introducing the Ability to Lodge a Consolidated Letter of Credit' (P158) seeks to modify the Balancing and Settlement Code ("the Code") to allow a group of BSC Parties to lodge a single consolidated Letter of Credit (LoC). The consolidated LoC would be sub-divided and specific amounts of Credit Cover allocated against each BSC Party/BSC Party Id², as opposed to posting an individual LoC for each BSC Party. The Proposer asserts that P158 would not alter the method of calculating a Party's Energy Indebtedness (pursuant to Section M 1.2 of the Code), which would still be calculated at a BSC Party level rather than against a group of BSC Parties.

The Proposer intends that P158 be introduced on a voluntary basis. Figure 1 below, diagrammatically explains how the consolidated LoC would be sub-divided against a number of BSC Parties.

Figure 1: Example Sub-division of a consolidated Letter of Credit



Currently the Code specifies, pursuant to Section M 2.1.1, that a LoC can only be lodged against an individual Party. The Code only contains provisions for a Trading Party (BSC Party) to apply for a single LoC (Annex M-1), thus preventing a group of Trading Parties from lodging a consolidated LoC.

The Code considers each Trading Party's application of Credit Cover on a separate basis and the Proposer believes this to be a defect within the current drafting of the Code. The Proposer therefore, believes that it would be appropriate for an additional consolidated LoC application form to be included in Section M 'Credit Cover and Credit Default' of the Code - potentially referenced as 'Annex M-2' which would allow a group of BSC Parties to lodge a consolidated LoC.

² Reference to BSC Party Id in the Modification refers to the unique Id given to each BSC Party (see Section A 4.3.3 of the Code) and should not be confused with the Supplier Id allocated to Supply Businesses and defined in Section S 1.3.

The Proposer asserts that P158 would assist BSCCo and the Funds Administration Agent (FAA) in managing the Credit Cover process. P158 will reduce the number of Credit Cover applications submitted by BSC Parties and therefore reduce the administrative burden placed on the FAA. The Proposer also believes that P158 would reduce the level of monitoring required by the FAA as P158 would reduce the monitoring obligations of the FAA as set out in the Code (detailed in Section M 2.2.3) - whereby the FAA notifies BSC Parties in advance of their impending LoC expiry date.

The Proposer therefore believes that P158 would better facilitate the achievement of Applicable BSC Objective (d) – “Promoting efficiency in the implementation and administration of the balancing and settlement arrangements”, by reducing administrative burdens on BSC Parties, BSCCo and the FAA.

Furthermore the Proposer believes that P158 would better facilitate achievement of Applicable BSC Objective (c) – “Promoting effective competition in the generation and supply of electricity and promoting competition in the sale and purchase of electricity”, as BSC Parties would be able to source Credit Cover more efficiently. It would also reduce the administration of having to refresh several LoCs a year.

P158 Initial Written Assessment was presented to the Panel on 12 February 2004, where it was submitted to the Assessment Procedure for two months.

During the Assessment Procedure, the SSMG met three times on 16 February, 25 February and 18 March 2004. The SSMG also issued a consultation document for industry feedback on 16 March 2004.

The Assessment Report (v1.0) was initially presented to the Panel at its meeting on 8 April 2004 with a recommendation for rejection. At its meeting the Panel submitted P158 for a further one month assessment, in order to allow industry participants the opportunity to have sight of information not available at the time of the first consultation.

During the one month further assessment, the SSMG conducted a second industry consultation. The SSMG requested that industry participants comment on:

1. Whether P158 better facilitated the achievement of the Applicable BSC Objectives;
2. The perceived Party cost benefits including quantification of these benefits; and
3. The perceived level of assurance of a consolidated LoC.

A revised Assessment Report (v2.0) reflecting the Group’s recommendations regarding P158, and additional information prepared in response to the Panel’s request for further analysis was prepared for the May 2004 Panel meeting.

Version 2.0 of the Assessment Report, and the draft legal text contained within it, form the basis for the findings in this draft Modification Report.

1.2 Proposed Modification

The SSMG, after considering the issues set out in section 1.3 agreed the following mechanism to give effect to P158:

- A BSC Party (the Umbrella Company) would lodge a consolidated LoC with a bank on behalf of a group of BSC Parties. The group of Parties would then submit a consolidated LoC application to the FAA, using the proposed Annex M-2 form of the Code (defined in Annex 1 of this document - legal text). This form would provide a breakdown of each Party’s ring-fenced amount of Credit Cover and the FAA would record and treat each of these as separate single LoCs;

- Upon receiving the consolidated LoC application, the FAA would check the affiliation status of the Party group with 'Companies House'. If the FAA deemed this group to be 'affiliated', the consolidated LoC would be approved;
- The FAA would be responsible for monitoring the amount of Credit Cover allocated to each BSC Party covered by the consolidated LoC. However, this would not require a new process as each Party's Credit Cover would be treated as a single LoC;
- If a Party went into Default (for whatever reason) and the FAA were to call upon a Party's Credit Cover, the FAA would only be able to call upon that Party's Credit Cover, as the 'ring-fenced amount would be treated as a single LoC. Therefore, this would not impact any other Party within the affiliate group; and
- If for whatever reason, the Umbrella Company was unable to renew the consolidated LoC on time, this could potentially put the entire LoC into Credit Default. However, P158 would be introduced on a voluntary basis and Parties should be aware of this risk, prior to lodging a consolidated LoC.

1.3 Issues raised by the Proposed Modification

The following issues were considered during the Assessment of Proposed Modification P158:

- Criteria for lodging a consolidated LoC;
- Affiliation versus Non Affiliation;
- Apportionment of the consolidated LoC;
- Default;
- Withdrawal of a Party from a consolidated LoC;
- Format of a consolidated LoC;
- Cash Cover;
- Usage of consolidated LoCs; and
- Assessment of Risk.

These issues are discussed in the Assessment Report (Reference 4) and are not covered further here.

1.4 Assessment of how the Proposed Modification will better facilitate the Applicable BSC Objectives

The Proposer contended that P158 would better facilitate the following Applicable BSC Objectives:

- (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; and
- (d) Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

The Group considered whether P158 better facilitates the above, and reached the following conclusions:

1.4.1 Applicable BSC Objective (d)

The SSMG unanimously agreed that P158 did not better facilitate Applicable BSC Objective (d).

The SSMG agreed that P158 would not provide central cost savings for BSCCo or the FAA and noted legal advice that potential savings to Parties should be considered against Applicable BSC Objective (c).

1.4.2 Applicable BSC Objective (c)

Majority View Against Proposed Modification

The majority of the SSMG were of the view that Proposed Modification P158 would not better facilitate Applicable BSC Objective (c).

The following arguments represent the views of the majority of the SSMG in that P158 would not better facilitate the Applicable BSC Objectives. A proportion of this majority were of the opinion that, although P158 does not better facilitate the Applicable BSC Objectives, P158 would not necessarily increase risk. Whereas the remainder of this majority were of the opinion that P158 would increase risk. Therefore, the following arguments are represented separately below:

SSMG opinion that P158 posed an increased risk and would not better facilitate the Applicable BSC Objectives:

- That there is a relative lack of historical evidence to suggest that a consolidated LoC has been utilised in the past. Whilst acknowledging the external legal advice obtained by BSCCo, some members of the SSMG were of the opinion that the drafting of the consolidated LoC does not provide an equal level of assurance when compared to the current single LoC;
- That the untested methodology of the consolidated LoC process could potentially weaken the existing LoC process and jeopardise the markets' confidence in LoCs and therefore increase the barrier to entry. The SSMG also felt that a new process would be inherent of risk;
- That the lender may potentially exploit loop-holes in the consolidated LoC. This could result in the lender not honouring the LoC and therefore potentially subjecting the rest of the market to the risk of having to settle the outstanding liabilities of a defaulting Party. The SSMG felt that this was an example of the potential risks that could be introduced as a result of implementing P158 and strengthens the argument that it would have a negative impact on competition;
- That any amendments made to a consolidated LoC would be carried out purely by the Umbrella Company and not by the individual Parties covered by the LoC. This could potentially be seen as detrimental to the flexibility of the current LoC amendment process. However, in relation to this point the SSMG noted that a Party's decision to lodge a consolidated LoC would be a voluntary and commercial decision and the strength of this argument could be weakened by the fact that applicants should consider these issues prior to lodging a consolidated LoC; and
- That although there were potential savings for Parties renewing multiple LoCs, this benefit was outweighed by the risks associated with the consolidated LoC.

SSMG opinion that P158 would not increase risk, but did not better facilitate the Applicable BSC Objectives:

- That although there were potential savings to Parties, it was considered that this benefit was limited to specific types of Parties and was not sufficient enough to better facilitate Applicable BSC Objective (c); and
- That the uncertainty created by the perceived risks identified by some participants outweighs any efficiency savings to Parties.

Minority view in Support of Proposed Modification

The minority of the SSMG (the Proposer) was of the view that P158 would better facilitate achievement of Applicable BSC Objective (c) by promoting competition.

The following arguments were expressed in support of this view:

- That P158 offers existing Parties and those entering the market a more efficient mechanism for sourcing Credit Cover;
- That P158 offers Parties the ability to reduce administration costs by reducing the number of LoCs and labour resources used to lodge and refresh LoC on behalf of its BSC Parties. This minority view also acknowledged that this benefit, albeit small, was significant for those Parties who wished to lodge a consolidated LoC;
- That there were no additional risks associated with the consolidated LoC, as BSCCo had sought advice from an external legal advisor as well as from an external LoC expert. Both of which confirmed that the consolidated LoC was robust; and
- That potential loop holes could equally exist under the current single LoC.

The minority of the SSMG therefore, concluded that P158 would improve competition by increasing efficiency of the credit arrangements for Parties using consolidated LoCs, with no impact on risk and no change to the level of protection for Parties.

1.4.3 Conclusion

Further to the SSMG's review of the P158 Assessment Procedure consultation responses and the additional information provided by external sources (refer to the P158 Assessment Report, reference 4), the majority of the SSMG concluded that P158, may offer potential administrative benefits for Parties thus promoting Applicable BSC Objective (c). However, this is outweighed by the perceived risks associated with a consolidated LoC. Therefore, the majority of the SSMG believe that P158 would not better facilitate achievement of Applicable BSC Objectives (c) or (d) and as a result should not be made.

1.5 Modification Group's cost benefit analysis of Proposed Modification

The SSMG acknowledged that there were central costs associated with the implementation of P158 (see Section 2 for full costs). The SSMG also noted that there were no operational savings to BSCCo or the FAA to be realised via a reduced administrative burden, therefore the SSMG determined that there were no potential central cost savings associated with P158.

The SSMG also considered the potential Party cost savings highlighted by industry participants during the second consultation. The two main potential cost benefits identified by the Proposer were as follows:

1. Cost of renewing multiple LoC would be reduced – The Proposer indicated that their company had estimated a cost saving of £3,500 per annum (14 LoC at £250 'refresher' charge paid to the lender for each LoC); and
2. Operational savings from renewing one consolidated LoC rather than several LoCs at different points in the year. The Proposer indicated that their company had estimated a cost saving of £7,500 in reduced man hours associated with renewing Credit Cover.

The Proposer therefore, estimated a potential cost saving for their affiliated group of £11,000 per annum associated with P158.

The SSMG also considered the figures provided by two further respondents. The first indicated an estimated saving of not more than £5,000 per annum and the second estimated £500 - £1,000 per annum. Both respondents were unable to provide a breakdown on their figures, and further stated that their Parties would not currently utilise a consolidated LoC.

The SSMG noted that it would be possible to realise the operational savings under the current baseline by aligning the renewal dates of single LoCs. However, under this approach there would not be a cost saving in relation to the fixed cost of renewing multiple LoCs, as each single LoC would require a refresher payment; whereas a consolidated LoC would only require one refresher payment.

The SSMG concluded that P158 offered a small potential cost benefit (in the order of £5k per annum per affiliated group) over the existing baseline for Parties wanting to use a consolidated LoC and that there were no central cost savings. It was also noted by the SSMG that only one Party (the Proposer) had indicated that they would utilise a consolidated LoC at this time.

1.6 Alternative Modification

The SSMG did consider an industry respondent's comment that all forms of Credit should have the ability to be consolidated, including cash cover. This respondent believed that to not include all forms of credit provisions would be discriminatory and would have a negative impact on the industry. However, this issue had already been considered by the SSMG and its decision was to rule out the inclusion of cash cover. Therefore, no Alternative Modification was developed.

1.7 Governance and regulatory framework assessment

During the assessment of the Proposed Modification, the SSMG also considered the wider implications of P158 in the context of the statutory, regulatory and contractual framework within which the Code sits, as is required by the Code (Annex F-1, paragraph 1(g)). The SSMG was of the opinion that, were P158 to be implemented, there would be no such wider implications.

2 COSTS³

The following P158 costs are associated with implementing P158 with the FAA undertaking the role of checking the affiliation status of Parties wishing to lodge a consolidated LoC.

PROGRESSING MODIFICATION PROPOSAL

Demand Led Cost	£ 5,500 ⁴
ELEXON Resource	45 Man days £8,450

IMPLEMENTATION COSTS

³ Clarification of the meanings of the cost terms in this section can be found in annex 3 of this report

⁴ Demand Led Costs were not incorporated in the IWA, however, the group requested external legal advice and LoC expert advice. An estimate of this cost has been included.

		Stand Alone Cost	P158 Incremental Cost	Tolerance
Service Provider⁵ Cost	Change Specific Cost	£0	£0	N/A
	Release Cost	£0	£0	N/A
	Incremental Release Cost	£0	£0	N/A
	Total Service Provider Cost	£0	£0	N/A
Implementation Cost		£0	£0	
	External Audit	£0	£0	N/A
	Design Clarifications	£0	£0	N/A
	Additional Resource Costs	£0	£0	N/A
	Additional Testing and Audit Support Costs	£0	£0	N/A
Total Demand Led Implementation Cost		£0	£0	N/A

ELEXON Implementation Resource Cost		79 Man days £31,600	34 Man days £13,600	+5%
Total Implementation Cost		£31,600	£13,600	+5%

ONGOING SUPPORT AND MAINTENANCE COSTS

	Stand Alone Cost	P158 Incremental Cost	Tolerance
Service Provider Operation Cost	£0	£0	N/A
Service Provider Maintenance Cost	£0	£0	N/A
ELEXON Operational Cost	£0	£0	N/A

⁵ BSC Agent and non-BSC Agent Service Provider and software Costs

3 RATIONALE FOR PANEL'S RECOMMENDATIONS

The Panel supported the findings of the SSMG, that P158 would not better facilitate achievement of either Applicable BSC Objective (c) or (d) for the reasons detailed in section 1.4 of this document.

The Panel acknowledged the further analysis undertaken by the SSMG and the two main issues for recommending that P158 should not be made. Firstly, the Panel supported the concerns of the SSMG that a consolidated LoC, proposed under P158, was largely based on an untested methodology and would require a new process which would be inherent of risk. Secondly, the Panel noted that the small benefits P158 had to offer would be limited to only one to two (large) Parties and that these negligible benefits would be outweighed by the potential risks to industry, were a consolidated LoC flawed in some way.

The Panel has reached a provisional recommendation that Proposed Modification P158 should not be made. The Panel also agreed an Implementation Date of 3 November 2004, with a fallback date of 23 February 2005 following an Authority decision.

4 IMPACT ON BSC SYSTEMS AND PARTIES

An assessment has been undertaken in respect of BSC Systems and Parties and the following areas have been identified as potentially being impacted by the Proposed Modification.

As agreed by the SSMG, the impacts discussed below are in relation to the FAA undertaking the affiliation checking process.

4.1 BSCCo

The CVA Programme would be impacted by P158 as it would need to implement the relevant changes to the FAA Service Description and BSCP301 'Clearing, Invoicing and Payment'. This documentation would be updated to accommodate a consolidated LoC and to reflect the affiliation checking process, which the FAA would facilitate. 20 man days effort would be required to implement these changes.

The Service Delivery team would require 14 man days effort in order to update its working practice in line with the consolidated LoC process.

4.2 BSC Agent

No impact on BSC Agent Systems were identified during the Assessment Procedure of Modification Proposal P158. However, there would be an impact on the FAA Credit Cover management process. The affiliation checking process would need to be included as an additional step to processing of LoC applications (refer to Assessment Report, Reference 4).

4.3 Parties and Party Agents

No impacts were identified on Parties and Party Agents during the Assessment Procedure of P158 (refer to Assessment Report, Reference 4). However, as P158 will be introduced on a voluntary basis, Party processes may need to be amended to include the lodging of consolidated LoCs.

5 IMPACT ON CODE AND DOCUMENTATION

5.1 Balancing and Settlement Code

The Proposed Modification requires changes to Section M 'Credit Cover and Credit Default' and Section N 'Clearing, Invoicing and Payment'.

The draft legal text is attached to this document (Annex 1).

Section M 2.1 'Provision of Credit Cover', describes the options for providing Credit Cover. Section 2.1.1 (c) will need to be added to include the use of a consolidated LoC. This section (M2.1.1.A) also defines the criteria for who can lodge a consolidated LoC i.e. affiliate group.

Section M2.1.2 will need to be amended to include the use of a consolidated LoC.

Section M2.1.3 which defines the amount of a Trading Party's Credit Cover will need to be amended to accommodate for the sum of individual Trading Party's covered by a consolidated LoC.

An additional clause will need to be added to section M2.1.5, which refers to the location of the consolidated LoC (Annex-M2).

Section M2.2 'Letter of Credit' has an additional clause, Section M2.2.1A, which extends the reference of a LoC to incorporate a consolidated LoC.

Section M2.3, which defines the process for a Party wishing to reduce its Credit Cover, will need to be extended (Section 2.3.1(c) (ii)) to reflect the ability for Trading Parties, covered by a consolidated LoC, to request a reduction in Credit Cover.

Annex M-2 'Consolidated Form of Letter of Credit' will need to be incorporated to allow a group of affiliated Parties to lodge a consolidated LoC application.

Section N9 which sets out the provisions that govern Payment Default, will include an additional clause, section N9.1.1A, which will clarify that if a Party, covered by a consolidated LoC, can not pay its Trading Charges and goes in to Payment Default, only the Credit Cover associated with that Party could be called by the FAA, as its portion of credit would be treated as a single LoC. Therefore, the rest of the group covered by the consolidated LoC would not be affected by an individual Party failing to pay its Trading Charges.

Section X 'Definitions and Interpretation', Annex X-1 'General Glossary' will need to be updated to incorporate a definition of a consolidated LoC.

5.2 Code Subsidiary Documents

The Proposed Modification P158 would impact the following Code Subsidiary Documents:

- The FAA Service Description - include a description of a consolidated LoC. Other changes would include an update to the Credit Cover management process to reflect the use of a consolidated LoC and to ensure that the affiliation checking process is included (defined in the Assessment Report, Reference 4).
- BSCP301 'Clearing, Invoicing and Payment' - In particular Section 3.6 'Manage Credit Cover' would need to be updated to define the process for re-structuring Credit Cover allocations across a group of BSC Parties, covered by a consolidated LoC.

5.3 Other Configurable Items

The Proposed Modification P158 would impact the following other Configurable items:

- FAA User Requirements Specification – changes to reflect the definition of a consolidated LoC and to include a description of the affiliation checking process.

5.4 BSCCo Memorandum and Articles of Association

No amendments would be required to the BSCCo Memorandum and Articles of Association as a consequence of the Proposed Modification.

5.5 Impact on Core Industry Documents and supporting arrangements

No changes would be required to any Core Industry Documents or supporting arrangements if the Proposed Modification were to be made.

6 SUMMARY OF CONSULTATIONS

6.1 Modification Group's summary of the consultation responses

[To be completed following Report Phase consultation].

Consultation question	Respondent agrees	Respondent disagrees	Opinion unexpressed
Do you agree with the Panel's views regarding P158 and the provisional recommendation to the Authority contained in the draft Modification Report that the Proposed Modification should not be made?			
Do you agree with the Panel's view that the draft legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal?			
Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P158?			

7 SUMMARY OF EXTERNAL ADVICE

During the initial assessment procedure the SSMG asked BSCCo to seek external legal advice on the robustness of the draft legal text for P158. The findings are discussed below:

7.1 Consultant's Findings

BSCCo's legal department sought external legal advice regarding the robustness of the draft consolidated LoC (Annex M-2) and clarification was provided by the external legal source that it was considered to be robust.

BSCCo also sought further advice from an external LoC expert who provided extra reassurance that the consolidated LoC was robust.

Further advice was received from a banking source, provided by the FAA (refer to Assessment Report, Reference 4). Its view was that banks might not be comfortable with accepting a consolidated LoC due to the perceived extra work involved and greater potential for errors. The source also suggested that if the FAA wanted to make a claim against one Party within the consolidated group and the Party was not satisfied with the grounds for such a claim (for whatever reason), it might seek a court injunction to stop the bank paying the FAA. This injunction may then take effect against the whole LoC, thereby freezing all the other Party's Credit Cover within the group. Therefore, this could potentially put all the Parties within the group into Credit Default. However, if it was just a single applicant LoC there would not be this knock on effect.

In light of this view, the Proposer consulted a legal advisor (refer to Assessment Report, Reference 4) who suggested that it would be no more likely that an affiliate Party would obtain a court injunction

than at present where affiliates have separate LoCs. The legal advisor also proposed that if the initial source was concerned over a court granting an injunction to prevent payment, this would not entail any additional increased risk on multi Party LoCs and that this could be remedied by a simple clause stating that "the bank has an obligation to pay, notwithstanding any objection from a multiple applicant".

With respect to this additional wording, BSCCo sought advice from an external legal advisor to see if this clause would have any impact on a bank's obligation to pay outstanding liabilities, were an entire consolidated LoC to be frozen. The advisor confirmed that in the unlikely event that this scenario were to happen, the additional wording would not provide any further obligations on the bank to pay. BSCCo also contacted the initial banking source who raised the concerns of freezing an entire LoC, who were of the opinion that the additional wording would not provide any new obligations on banks to pay. It also confirmed that the initial risk of freezing a consolidated LoC was still valid, although it was an unlikely event.

The Proposer also obtained confirmation from an additional banking source that they would be comfortable with accepting a consolidated LoC of the form suggested by P158.

7.2 Comments and views of the Panel

The Panel noted the additional information provided and supported the SSMG's view that although the proposed P158 consolidated LoC was considered robust by external legal advisors this type of LoC was still primarily based on untested methodology, which would be inherent of risk.

8 IMPLEMENTATION APPROACH

The Panel noted that there would be no impact on Central Systems, but that a new process would be required for the FAA to undertake the role of checking the affiliation status of Parties. Therefore, this would require changes to BSCP301.

The Panel agreed that P158 should be implemented as part of an existing planned release in order to minimise implementation costs, and noted BSCCo's advice that the next available planned releases which could incorporate P158 would be November 2004 or February 2005.

The SSMG therefore agreed the following provisional Implementation Dates:

- 3 November 2004 if an Authority Decision is received on or before 30 July 2004; or
- 23 February 2005 if an Authority Decision is received after this date but on or before the 12 November 2004.

9 DOCUMENT CONTROL

9.1 Authorities

Version	Date	Author	Reviewer	Change Reference
0.1	19/05/04	Michelle Spurden	Thomas Bowcutt / Sarah Parsons	For peer review
0.2	20/05/04	Michelle Spurden	BSC Parties/other interested parties	For consultation
0.3	dd/mm/yy	Michelle Spurden	Change Delivery	For technical review
0.4	dd/mm/yy	Michelle Spurden	Change Delivery	For quality review
0.5	dd/mm/yy	Change Delivery	BSC Panel	For Panel review & approval
1.0	dd/mm/yy	BSC Panel		For Authority decision

9.2 References

Ref	Document	Owner	Issue date	Version
1	Modification Proposal P158 'Introducing the Ability to Lodge a Consolidated LoC' http://www.elexon.co.uk/docs/ta/modifications/modsprops/P158/p158.pdf	BSCCo	27/01/2004	1.0
2	Initial Written Assessment for Modification Proposal P158 'Introducing the Ability to Lodge a Consolidated LoC' http://www.elexon.co.uk/docs/ta/modifications/modsprops/P158/IWA_FINAL.pdf	BSCCo	06/02/2004	1.0
3	V 1.0 Assessment Report for Modification Proposal P158 'Introducing the Ability to Lodge a Consolidated LoC' http://www.elexon.co.uk/docs/ta/modifications/modsprops/P158/75_007a_P158.pdf	BSCCo	02/04/2004	1.0
4	V 2.0 Assessment Report for Modification Proposal P158 'Introducing the Ability to Lodge a Consolidated LoC' http://www.elexon.co.uk/docs/ta/modifications/modsprops/P158/77_009a_P158_AR.pdf	BSCCo	07/05/2004	2.0
5	Requirements Specification for Modification P158 'Introducing the Ability to Lodge a Consolidated LoC' http://www.elexon.co.uk/docs/ta/modifications/modsprops/P158/P158_ReqSpecFINAL.pdf	BSCCo	09/03/2004	1.0

ANNEX 1 DRAFT LEGAL TEXT

Text for Proposed Modification – see Attachment 1

ANNEX 2 MODIFICATION GROUP DETAILS

Settlement Standing Modification Group (SSMG)

Modification Proposal P158

Name	Organisation (Role)	Member	Meeting Attendance		
			16/02/04	25/03/04	18/03/04
Thomas Bowcutt	ELEXON (Chairman)	Y	Y	Y	N
Roger Salomone	ELEXON (Chairman)	Y	N	N	Y
Michelle Spurden	ELEXON (Lead Analyst)	Y	Y	Y	Y
Mark Manley	BGT (Proposer)	Y	Y	Y	Y
Carl Wilkes	Npower	Y	Y	Y	Y
Helen Bray	London Electricity	Y	Y	N	N
Man Kwong Liu	Scottish Power	Y	Y	Y	N
Neil Smith	Powergen	Y	Y	Y	Y
Phil Russell	Not Applicable	Y	N	N	N
Steve Drummond	EDF Trading	Y	Y	N	N
Joanne Ellis	Cornwall Consulting	N	N	N	N
Kevin Rendell	NGT	Y	N	N	N
Martin Wiles	Logica CMG EPFAL	N	Y	Y	N
Thomas Wood	Logica CMG EPFAL	N	Y	Y	Y
Paul Davis	Logica CMG EPFAL	N	N	N	Y
Steve Mackay	Ofgem	N	Y	Y	Y

SSMG Terms of Reference

Modification Proposal P158 will be considered by the SSMG in accordance with the SSMG Terms of Reference.

P158 – Introducing the ability to lodge a consolidated Letter of Credit (LoC)

Assessment Procedure

- 1.1 The Modification Group will carry out an Assessment Procedure in respect of Modification Proposal P158 pursuant to section F2.6 of the BSC.
- 1.2 The Modification Group will produce an Assessment Report for consideration at the BSC Panel Meeting on 8 April 2004.
- 1.3 The Modification Group shall consider and/or include in the Assessment Report as appropriate:
 - **Criteria for qualifying for a consolidated LoC** – Consideration is required as to who can apply for a consolidated LoC, i.e. whether this should only apply to affiliated companies / companies within the same group, or whether the process should be extended such that any arbitrary group of unrelated BSC Parties can elect to submit a consolidated LoC. In either instance, consideration should be given to the implications of, and the process to be followed where, one or more of the BSC Parties to whom the LoC applied left the group, and / or other BSC Parties joined the group;
 - **Number of Parties using Consolidated LoC** – If it is determined that applying for a consolidated LoC should be restricted to affiliated companies/companies within the same group, the Modification Group should consider how many Parties this would apply to;
 - **Impact on different types of Parties** – The Modification Group should consider whether allowing affiliated companies to apply for a consolidated LoC would create any unfair advantages over Parties who are not part of a larger company group;
 - **Apportionment of LoC** – Consideration is required to be given as to whether the apportionment of Credit Cover between BSC Parties is to be fixed at the point at which the LoC is first provided, or whether the credit could be dynamically reallocated between the BSC Parties covered by the LoC at any point, following a yet to be defined process;
 - **Reduction in Credit Cover** - In the event that a BSC Party covered by the consolidated LoC wishes to reduce its Credit Cover the Modification Proposal implies that it will have to continue to go through the 'minimum eligible amount' (MEA) process, as detailed in Section M 2.3 of the Code, as the Proposal asserts that once Credit Cover has been apportioned, the currently defined processes for managing that Credit Cover will apply to each BSC Party. However, this process may be impacted by P158, for example if a dynamic apportionment process which bypasses the MEA process is defined, and thus any impacts and amendments will need to be identified;
 - **Increase in Credit Cover** - In the event that a BSC Party covered by the consolidated LoC wishes to increase its Credit Cover, processes for doing so may need to be defined. For example the increase could be achieved from the re-apportionment of credit from another Party covered by the LoC, or could be achieved by replacing the LoC with a new one for an increased amount, or even by lodging a new LoC specific to the one BSC Party for the additional amount required;
 - **Default** – Issues may arise from having a consolidated LoC under different Default circumstances, for example:
 - i **Default under the Code:** Currently, if a Party Defaults under the Code, pursuant to Section H.3.2.1, its Credit Cover is frozen, and this may have implications on the consolidated LoC and require a new / amended process for managing this;
 - ii **Payment Default:** If a Party is unable to pay its Trading Charges the BSCCo may decide to call upon any lodged Credit Cover, and the implications of calling on a consolidated

LoC should be explored, specifically for the example where the default amount exceeds the apportioned Credit Cover;

- iii Credit Default: Issues may arise where a Party with a consolidated LoC fails to comply with renewal time-scales, potentially resulting in the entire LoC becoming invalid, impacting all the BSC Parties covered by the LoC; and
- iv Status of BSC Parties: Where a Party defaults, the Panel is obliged to take decisions in relation to that Party. Therefore consideration should be given as to whether a consolidated LoC prevents BSC Parties from being treated as individual entities by the Panel, or obliges the Panel to take different decisions.

The Modification Group should consider the implications of a consolidated LoC on the above circumstances.

- **Withdrawal of a Party from a consolidated LoC** – The Modification Group should consider what the provisions should be made to allow a BSC Party from a consolidated LoC if, for example, the Party is sold to another company.
- **Application to LoCs Only** – The Modification Proposal limits the consolidation of credit to LoCs only, by implication excluding cash cover. Therefore the rationale for this constraint should be explored, and where it is considered appropriate by the Modification Group, the process may be expanded to include the consolidation of other forms of credit; and
- **Legal / Commercial Issues** – The use of a consolidated LoC may create legal and / or commercial issues where multiple BSC Parties are covered by a single LoC. Therefore this aspect should be explored by the Modification Group to ensure that there are no legal / commercial inconsistencies with this approach.
- **Costs/benefits** – The Modification Group should assess the costs savings to Parties of using a consolidated Letter LoC.

ANNEX 3 CLARIFICATION OF COSTS

There are several different types of costs relating to the implementation of Modification Proposals. ELEXON implements the majority of Approved Modifications under its CVA or SVA Release Programmes. These Programmes incur a base overhead which is broadly stable whatever the content of the Release. On top of this each Approved Modification incurs an incremental implementation cost. The table of estimated costs of implementing the Proposed/Alternative Modification given in section 2 of this report has three columns:

- **Stand Alone Cost** – the cost of delivering the Modification as a stand alone project outside of a CVA or SVA Release, or the cost of a CVA or SVA Release with no other changes included in the Release scope. This is the estimated maximum cost that could be attributed to any one Modification implementation.
- **Incremental Cost** - the cost of adding that Modification Proposal to the scope of an existing release. This cost would also represent the potential saving if the Modification Proposal was to be removed from the scope of a release before development had started.
- **Tolerance** – the predicted limits of how certain the cost estimates included in the template are. The tolerance will be dependent on the complexity and certainty of the solution and the time allowed for the provision of an impact assessment by the Service Provider(s).

The cost breakdowns are shown below:

PROGRESSING MODIFICATION PROPOSAL	
Demand Led Cost	This is the third party cost of progressing a Modification Proposal through the Modification Procedures in accordance with Section F of the Code. Service Provider Impact Assessments are covered by a contractual charge and so the Demand Led cost will typically be zero unless external Legal assistance or external consultancy is required.
ELEXON Resource	This is the ELEXON Resource requirement to progress the Modification Proposal through the Modification Procedures. This is estimated using a standard formula based on the length of the Modification Procedure.

SERVICE PROVIDER⁶ COSTS	
Change Specific Cost	Cost of the Service Provider(s) Systems development and other activities relating specifically to the Modification Proposal.
Release Cost	Fixed cost associated with the development of the Service Provider(s) Systems as part of a release. This cost encompasses all the activities that would be undertaken regardless of the number or complexity of changes in the scope of a release. These activities include Project Management, the production of testing and deployment specifications and reports and various other standard release activities.
Incremental Release Cost	Additional costs on top of base Release Costs for delivering the specific Modification Proposal. For instance, the production of a Test Strategy and Test Report requires a certain amount of effort regardless of the number of changes to be tested, but the addition of a specific Modification Proposal may increase the scope of the Test Strategy and Test Report and hence incur additional costs.

IMPLEMENTATION COSTS	
External Audit	Allowance for the cost of external audit of the delivery of the release. For CVA BSC Systems Releases this is typically estimated as 8% of the total Service Provider Costs, with a tolerance of +/- 20%. At present the SVA Programme does not use an external auditor, so there is no External Audit cost associated with an SVA BSC Systems Release.
Design Clarifications	Allowance to cover the potential cost of making any amendments to the proposed solution to clarify any ambiguities identified during implementation. This is typically estimated as 5% of the total Service Provider Costs, with a tolerance of +/- 100%.
Additional Resource	Any short-term resource requirements in addition to the ELEXON resource available. For CVA BSC Systems Releases, this is typically only necessary if

⁶ A Service Provider can be a BSC Agent or a non-BSC Agent, which provides a service or software as part of the BSC and BSC Agent Systems. The Service Provider cost will be the sum of the costs for all Service Providers who are impacted by the release.

<p>Costs</p>	<p>the proposed solution for a Modification Proposal would require more extensive testing than normal, procurements or 'in-house' development.</p> <p>For SVA BSC Systems Releases, this will include the management and operation of the Acceptance Testing and the associated testing environment.</p> <p>This cost relates solely to the short-term employment of contract staff to assist in the implementation of the release.</p>
<p>Additional Testing and Audit Support Costs</p>	<p>Allowance for external assistance from the Service Provider(s) with testing, test environment and audit activities. Includes such activities as the creation of test environments and the operation of the Participant Test Service (PTS). For CVA BSC Systems Releases, this is typically estimated as £40k per release with a tolerance of +/-25%. For SVA BSC Systems Releases this is estimated on a Modification Proposal basis.</p>

TOTAL DEMAND LED IMPLEMENTATION COSTS

This is calculated as the sum of the total Service Provider(s) Cost and the total Implementation Cost. The tolerance associated with the Total Demand Led Implementation Cost is calculated as the weighted average of the individual Service Provider(s) Costs and Implementation Costs tolerances. This tolerance will be rounded to the nearest 5%.

ELEXON IMPLEMENTATION RESOURCE COSTS

Cost quoted in man days multiplied by project average daily rate, which represents the resources utilised by ELEXON in supporting the implementation of the release. This cost is typically funded from the "ELEXON Operational" budget using existing staff, but there may be instances where the total resources required to deliver a release exceeds the level of available ELEXON resources, in which case additional Demand Led Resources will be required.

The ELEXON Implementation Resource Cost will typically have a tolerance of +/- 5% associated with it.

ONGOING SUPPORT AND MAINTENANCE COSTS

<p>ELEXON Operational Cost</p>	<p>Cost, in man days per annum multiplied by project average daily rate, of operating the revised systems and processes post implementation.</p>
<p>Service Provider Operation Cost</p>	<p>Cost in £ per annum payable to the Service Provider(s) to cover staffing requirements, software or hardware licensing fees, communications charges or any hardware storage fees associated with the ongoing operation of the revised systems and processes.</p>
<p>Service Provider Maintenance Cost</p>	<p>Cost quoted in £ per annum payable to the Service Provider(s) to cover the maintenance of the amended BSC Systems.</p>

ANNEX 4 EXTERNAL CONSULTANTS/ADVISOR

For external consultants/advisors information, refer to Annex 7 of the Assessment Report (Reference 4).