77/009

ASSESSMENT REPORT for Modification Proposal P158

Introducing the Ability to lodge a Consolidated Letter of Credit

Prepared by: Settlement Standing Modification Group

Date of issue:	7 May 2004	**Document reference:**	P158AR
Reason for issue:	For Panel Decision	**Issue/Version number:**	Final/2.0

This document has been distributed in accordance with Section F2.1.10[1] of the Balancing and Settlement Code.

RECOMMENDATIONS

The Settlement Standing Modification Group (SSMG) invites the Panel to;

- **AGREE that the Proposed Modification P158 should not be made;**
- **AGREE a provisional Implementation Date for Proposed Modification P158 (in the event that the Authority determines that Proposed Modification P158 should be made) of 3 November 2004 should an Authority decision be 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;**
- **AGREE that Modification Proposal P158 be submitted to the Report Phase; and**
- **AGREE that the draft Modification Report be issued for consultation and submitted to the Panel Meeting of 10 June 2004.**

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

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SUMMARY OF IMPACTED PARTIES AND DOCUMENTS

As far as the SSMG has been able to assess the following parties/documents have been identified as being potentially impacted by Modification Proposal P158.

Parties	
Suppliers	☒
Generators	☒
Licence Exemptable Generators	☒
Transmission Company	☒
Interconnector	☒
Distribution System Operators	☐
Party Agents	
Data Aggregators	☐
Data Collectors	☐
Meter Operator Agents	☐
ECVNA	☐
MVRNA	☐
BSC Agents	
SAA	☐
FAA	☒
BMRA	☐
ECVAA	☐
CDCA	☐
TAA	☐
CRA	☐
Teleswitch Agent	☐
SVAA	☐
BSC Auditor	☐
Profile Administrator	☐
Certification Agent	☐
MIDP	☐
TLFA	☐
Other Agents	
SMRA	☐
Data Transmission Provider	☐

Sections of the BSC	
A	☐
B	☐
C	☐
D	☐
E	☐
F	☐
G	☐
H	☐
J	☐
K	☐
L	☐
M	☒
N	☒
O	☐
P	☐
Q	☐
R	☐
S	☐
T	☐
U	☐
V	☐
W	☐
X	☒

Code Subsidiary Documents	
BSC Procedures	☒
Codes of Practice	☐
BSC Service Descriptions	☒
Service Lines	☐
Data Catalogues	☐
Communication Requirements Documents	☐
Reporting Catalogue	☐
MIDS	☐
Core Industry Documents	
Grid Code	☐
Supplemental Agreements	☐
Ancillary Services Agreements	☐
Master Registration Agreement	☐
Data Transfer Services Agreement	☐
British Grid Systems Agreement	☐
Use of Interconnector Agreement	☐
Settlement Agreement for Scotland	☐
Distribution Codes	☐
Distribution Use of System Agreements	☐
Distribution Connection Agreements	☐
BSCCo	
Internal Working Procedures	☒
Other Documents	
Transmission Licence	☐

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

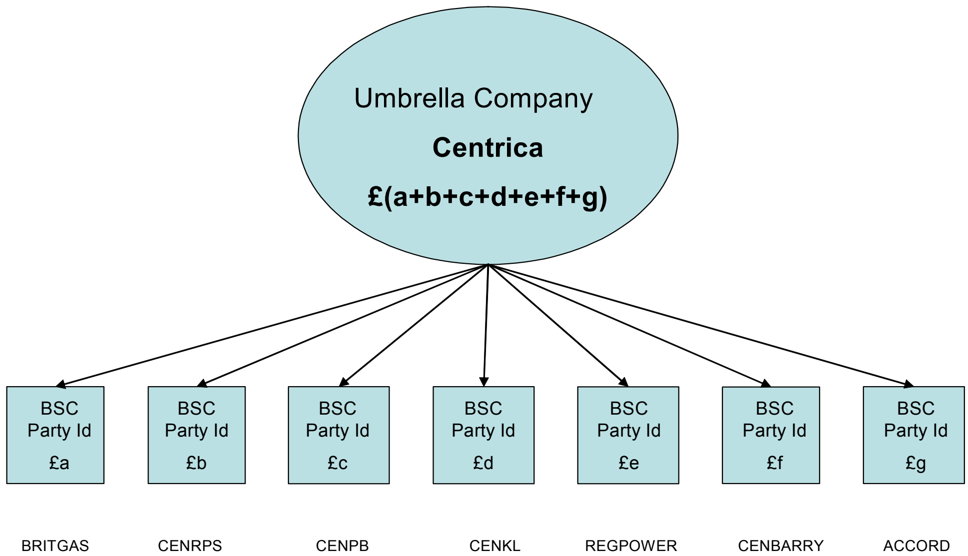
1 DESCRIPTION OF PROPOSED MODIFICATION AND ASSESSMENT AGAINST THE APPLICABLE BSC OBJECTIVES

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 Id[2], 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.

1.2 Process Followed

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. The SSMG also issued an industry consultation.

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.

1.3 Proposed Modification

The SSMG, after considering the issues set out in section 1.4 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 additional monitoring 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 is to be introduced on a voluntary basis and Parties should be made aware of this risk, prior to lodging a consolidated LoC.

1.4 Issues raised by the Proposed Modification

During the course of the Assessment Procedure, the SSMG considered the following issues:

- 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;
- Cost benefits; and
- Assessment of Risk.

The following subsections document the discussions and conclusions of the SSMG in relation to each of the above issues.

1.4.1.1 Criteria for lodging a consolidated LoC

The SSMG have considered the criteria for lodging consolidated LoCs under P158 and initially agreed that only affiliated companies should be eligible. It was the view of the SSMG that the definition of affiliation currently used to define a 'trading party group' for the purpose of BSC voting (pursuant to Annex B-2 'Election of Industry Panel Members', section 3.1.5) should be utilised under P158. This section outlines the issues considered by the SSMG and the arguments from which the SSMG drew its initial conclusion.

1.4.1.2 Affiliation verses Non Affiliation

The SSMG considered whether limiting the consolidated LoC to groups of Parties meeting the existing Code definition of Affiliate (Section X Annex X-1) would discriminate against smaller Parties. Therefore, the SSMG considered the possibility of allowing an arbitrary group of BSC Parties to post a consolidated LoC.

Following further discussion, the SSMG noted that there would be two qualifying requirements for lodging a consolidated LoC under P158 as follows:

- Qualification criteria introduced via Code requirements (i.e. the groups of companies the Code is willing to accept a consolidated LoC for); and
- Qualification criteria under bank requirements (i.e. the groups of companies for which a bank is willing to provide a consolidated LoC for).

The SSMG noted that any criteria an individual bank sets when agreeing to provide a consolidated LoC for an Umbrella Party (to cover a number of affiliated or un-affiliated BSC Parties), would be outside of the scope of the Code. Also it was the view of the SSMG that, although banks may agree to provide a LoC for affiliated companies, it was unlikely that this would be the case for an arbitrary group.

In addition were a bank to issue a consolidated LoC for an arbitrary group and any Party in that group were to have its Credit Cover called upon by the FAA, the FAA would directly contact the lender (bank) of the LoC to request the payment of funds. As the Umbrella Company lodged the original consolidated LoC with the bank, the bank would therefore hold the Umbrella Company responsible for providing the outstanding funds. Therefore the overall risk would sit with the Umbrella Company. The SSMG felt that this process would be difficult for any such group in terms of either increasing or decreasing its amount of Credit Cover as this would need to be coordinated through the Umbrella Company.

The SSMG noted the FAA view that, if a valid consolidated LoC was provided by a bank, the FAA would be in a position to call upon any element of that amount, at any time, independent of any criteria for posting LoC under the Code (as each ring-fenced amount of credit would be treated as a single LoC) i.e. the ability of the FAA to call a consolidated LoC would not be dependent on affiliation status or otherwise of the Parties covered.

Whilst, the SSMG noted that this was a workable solution for P158 some members of the SSMG suggested that affiliation would provide a greater level of assurance in terms of the level of risk Parties could potentially be exposed to, were a Party to go into default for what ever reason.

Therefore the group agreed that only affiliated companies would be eligible to post a consolidated LoC under P158.

1.4.1.3 Checking Affiliation Status

The SSMG also considered the implications of limiting the criteria for lodging consolidated LoCs to affiliate groups and noted that this would require a new process for checking a Party's affiliation status. The SSMG considered who would be responsible for managing this process i.e. the FAA or BSCCo. The arguments for and against are outlined below:

BSCCo:

Under P158, the consolidated LoC process would commence with a Party lodging a consolidated LoC application with the FAA, this is in line with the existing process currently defined under the Code and within the FAA Service Description for lodging a single LoC. On receipt of an application for a consolidated LoC, the FAA would be required to notify BSCCo. BSCCo would then run a check on the affiliation status of that group of Parties through Companies House and inform the FAA of the results from that check, i.e. the group is genuinely affiliated or not. The FAA would then take the necessary steps to either accept the consolidated LoC application or reject it.

The results from the BSCCo and FAA Impact Assessment suggest that, if BSCCo were to undertake the affiliation checking process, the impact on BSCCo would not be insignificant. If BSCCo were required to undertake the affiliation check it would involve BSCCo obtaining information currently not operationally available and also the introduction of new defined manual flows between BSCCo and the FAA. BSCCo would also incur costs associated with accessing data from Companies House. It was also suggested that if the FAA were required to notify BSCCo of a consolidated LoC application and BSCCo were then required to run the affiliation check, this would create an unnecessary time-lag within the consolidated LoC application process.

FAA:

The results of the FAA Impact Assessment indicated that there would be no benefit in fragmenting the process of lodging a consolidated LoC and that this would be detrimental to the interest of the BSC Party lodging Credit Cover. The FAA proposed that it would be able to carry out the checks on the affiliation status and this would prevent any delays occurring in processing applications. Under this approach, the main impacts on documentation would be to BSCP301, which would need to be amended to allow the FAA to carry out the affiliation check. Changes to other documents such as the FAA Service Description, URS and IDD would be required but these would be minimal.

The initial FAA Impact Assessment stated that the FAA would absorb the cost of checking the affiliation status provided that Modification Proposals P142 and P152 were approved. However, the FAA later confirmed that it would absorb the cost of the affiliation process, independent of any other Modification being approved by the Authority.

The SSMG considered each argument for and against the FAA and BSCCo undertaking the affiliation checking process and concluded that the FAA was in a better position to facilitate this role.

1.4.1.4 Apportionment of the LoC

The SSMG have considered how credit would be apportioned between those Parties covered by a consolidated LoC. The SSMG agreed that the consolidated LoC would be lodged by the group of Trading Parties covered but would represent one underlying relationship between the lender (bank) and the 'Umbrella Company'. The group specified that each allocated portion of Credit Cover would be 'ring fenced' and treated the same way as a single LoC is under the current Code baseline.

Hence, under P158, if a Party wished to either increase or decrease its Credit Cover, then it would have to follow the processes currently defined under the Code for single LoCs. For example, a BSC Party wishing to decrease its ring fenced portion of a consolidated LoC, pursuant to Section M 2.3 'Reduction of Credit Cover', would need to apply through the 'minimum eligible amount' process as defined in section M 2.3.2(b). However, if a BSC Party wished to increase its ring fenced portion of a consolidated LoC it would still need to follow the rules currently defined in section M 2.1 'Provision of Credit Cover' and 2.2 'Letter of Credit' of the Code. Therefore, any changes to the Credit Cover of an individual Party covered by a consolidated LoC would require a new consolidated LoC to be posted. As such, an individual Party covered by a consolidated LoC would only be able to adjust its' Credit Cover amount with the involvement of the Umbrella Party (to which the bank has the direct relationship).

1.4.1.5 Default

The SSMG have considered how the default arrangements would apply to Parties covered by a consolidated LoC.

<u>Default under the Code:</u>

Currently, if a Party Defaults under the Code, pursuant to Section H.3.2.1, its Credit Cover will be frozen (until after the Final Reconciliation Run when a Party could apply to have any unused Credit Cover returned). The SSMG agreed that Parties covered by a consolidated LoC would be allocated individual, 'ring-fenced' amounts of Credit Cover which would be treated as an individual LoC. Therefore, if a Party Defaults under the Code only that individual Party would have its Credit Cover frozen and the remaining Parties within the group would not be impacted.

With regards to a Party being in default, the Panel is obliged to take decisions in relation to that Party. The SSMG agreed that this should not alter with the introduction of a consolidated LoC and that all affected Parties would be judged on an individual basis in relation to their portion of the consolidated LoC.

Payment Default:

If a Party fails to pay its Trading Charges, BSCCo may call on any lodged Credit Cover. In the event that a Party (covered by a consolidated LoC) 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 and would not be liable for any unpaid Trading Charges.

Credit Default:

If a Party fails to have sufficient Credit Cover lodged, BSCCo may deem the Party to be in Credit Default. In the event that a Party (covered by a consolidated LoC) goes in to Credit Default only that specific Party would be affected. Therefore, the rest of the group covered by the consolidated LoC would not be affected by an individual Party failing to lodge sufficient Credit Cover.

Renewal of LoC:

If the renewal timescales for a consolidated LoC covering a number of its BSC Parties are not met, the FAA would be able to call on the entire LoC (as the renewal dates of each single element would have expired at the same point in time). As such, the responsibility for renewing consolidated LoCs and the associated risk would sit with the Umbrella Company (since the lender has one underlying relationship with the Umbrella Company).

1.4.1.6 Withdrawal of a Party from a consolidated LoC

The SSMG considered what the implications would be if a Party, covered by a consolidated LoC were sold or voluntarily left the affiliated group. The SSMG consulted the view of the FAA, who confirmed that the unaffiliated Party's Credit Cover could still be called on by the FAA until the Umbrella Company issued a revised / lodged a new consolidated LoC and removed that Party's name from the form. Therefore, the Umbrella Company would be responsible for lodging a new LoC. If the Umbrella Company does not lodge a new LoC then it would potentially remain obligated if the unaffiliated Party's Credit Cover were to be called on by the FAA, i.e. if such a Party were in Payment Default. However, if the Umbrella Company had submitted a revised LoC, removing any reference to the Party that had been sold, then the new owners of that Party would be responsible for lodging Credit Cover for that Party. Failure to do so could mean that the Party was subject to default procedures in the Code.

The SSMG agreed that the risk of Parties leaving the affiliated group rested with the Umbrella Company. Therefore, it was agreed that once the initial affiliation check was carried out by the FAA, there would be no active monitoring of the affiliation status of Parties subject to a consolidated LoC.

1.4.1.7 Format of consolidated LoC

At its initial meeting, the group requested visibility of the draft legal text for Annex M2 'Consolidated Letter of Credit form' and sought reassurance that this form would be robust and legally binding (draft legal text is attached as Annex 1 of this document). The SSMG agreed that any consolidated LoC put forward under P158 should provide the market with an equivalent level of assurance to that provided by the existing single LoC. Therefore, the SSMG have taken the following steps in the preparation of the consolidated LoC:

- The FAA were invited to comment on the workability of the proposed drafting as part of the BSC Agent impact assessment of P158. No adverse comments on the workability of the consolidated LoC were made;

- The advice of an external LoC expert has been obtained and the comments provided incorporated into the drafting; and
- External legal advice on the format of the consolidated LoC has been taken and confirmed that the drafting is legally robust.

1.4.1.8 Cash Cover

The SSMG considered the extension of P158 to include cash cover and agreed that there would be no benefit in expanding the consolidated credit process to incorporate cash cover. The FAA confirmed that cash already gets 'ring-fenced' and put into a Reserve Account. Therefore, the SSMG agreed P158 would only be applicable for LoC.

1.4.1.9 Usage of consolidated LoCs

The SSMG considered the number of Parties which would potentially utilise the consolidated LoC. It was noted that only one respondent to industry consultation indicated that they would use a consolidated LoC at the present time.

1.4.1.10 Cost benefits

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 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 estimate 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.

1.4.1.11 Assessment of Risk

The SSMG have considered whether there would be an increased risk associated with P158 and whether a consolidated LoC provided less assurance than a single LoC.

The risk which the SSMG have considered relates to the introduction of a new form of LoC. Under the Code a Party, covered by a LoC, may go into Payment Default. In this situation the FAA may call on that Party's Credit Cover. However, if the bank does not honour the LoC, for example due to a flaw in the documents drafting, the market may be liable for the defaulting Party's charges. As such, if it was felt that the consolidated LoC was less robust that a single LoC. The introduction of the consolidated LoC as proposed by P158 would introduce a potential risk which the SSMG have considered and taken steps to minimise during the Assessment Procedure. The SSMG recognised that this potential risk identified was a low probability event, which had potentially severe consequences were it to occur.

During the Assessment Procedure a number of actions were undertaken to establish the robustness of the P158 consolidated LoC:

Legal Advice:

BSCCo sought advice from an external legal advisor who indicated that, although it was worth noting that this was a relatively untested process methodology, the consolidated LoC was considered to be legally robust.

LoC Expert:

BSCCo also sought advice from an external LoC expert who indicated that, although this was an untried document, it was considered to be robust.

Financial Bank Sources:

The SSMG considered the opinions of two banking sources who offered different opinions in relation to the proposed consolidated LoC.

The first banking source (provided by the Proposer) confirmed that it would accept a consolidated LoC (for further information, refer to section 8 and Annex 7). However, the second banking source (provided by the FAA) asserted that it would not want to enter into such a consolidated LoC agreement due to the extra work load involved. They also noted the potential risks of an entire consolidated LoC being frozen, details of which have been discussed in more detail below.

In light of the actions taken to minimise the risk, the SSMG have considered whether or not there would be a higher level of risk associated with the proposed LoC in comparison with the current baseline, single LoC. The following areas have been considered:

Freezing:

This risk was highlighted by a banking source, provided by the FAA, which indicated that it would not want to enter into such an agreement as P158. This source proposed that if the FAA were to call on a particular Party's Credit Cover from within the affiliate group (reasons for this might include that Party going into default) there was a potential risk that the defaulting Party might apply for a court injunction, preventing the bank from paying. The results of which may lead to the entire LoC being frozen.

This banking view highlighted risks as a result of a Party, covered by a consolidated LoC, going into default which impacts both the industry and other Parties from within the affiliate group. A breakdown of these risks has been identified as follows:

- Where a Party, covered by a consolidated LoC goes into Payment Default and a flaw in the LoC leads to the Credit Cover for that particular Party being frozen - all Trading Parties would be required to pay a share of any unsecured liabilities in relation to that Party. Therefore there is only an increased risk if the consolidated LoC is less robust than a single LoC, as this would increase the possibility of a frozen LoC and funds being recovered from other Trading Parties.

- Where a Party, covered by a consolidated LoC goes into Payment Default and the entire LoC becomes frozen, and in addition the other Parties covered by the consolidated LoC are still paying their Trading Charges (i.e. they are not in Payment Default) - the impact on all other Trading Parties would be the same as above. However, the affiliated Parties covered by the consolidated LoC would have their Credit Cover set to zero, which may lead to them going into Credit Default. Credit Default leads to the Party's name being published on the BSC website and may result in Volume Notifications being rejected. This doesn't have a financial impact on any other Party but is a risk to those who are part of the consolidated LoC.
- Where a Party, covered by a consolidated LoC goes into Payment Default and a flaw in the consolidated LoC leads to the entire LoC being frozen, and in addition the other Parties covered by the consolidated LoC stop paying their Trading Charges (i.e. they also go into Payment Default) - the Trading Charges owed by all Parties under the consolidated LoC would be collected from all other Trading Parties. However it should be noted that this would also be the case if each Party covered by the consolidated LoC had a separate LoC and each of these were to be frozen. Therefore there is only an increased risk if the consolidated LoC is less robust than a single LoC as this would increase the possibility of a frozen LoC and funds being recovered from other Trading Parties.

In light of the banking opinion, provided by the FAA, the Proposer sought internal legal advice to seek ways to counteract the associated risks of a bank not honouring a consolidated LoC. This legal advice confirmed that it was unlikely that a Party would be granted a court injunction. However, in order to reduce these risks further the Proposer's legal advisor suggested including an additional clause to the drafting of the consolidated LoC, which would serve to highlight a bank's obligation to pay charges associated with a consolidated LoC. The suggested wording was as follows; "the bank has an obligation to pay, notwithstanding any objection from a multiple applicant".

In light of this opinion, BSCCo undertook actions to investigate the strength of this wording in court. Firstly, BSCCo contacted the FAA and requested that its banking source provide a view as to whether the proposed wording would reduce the risk it initially identified, which was in relation to court injunctions and the freezing of entire consolidated LoCs. This banking source did not indicate a change from their initial view, however the opinion that the freezing of a LoC was only likely to occur in limited circumstances was reiterated.

Secondly, BSCCo contacted its external legal advisers who reiterated their view that the consolidated LoC was robust and therefore the additional wording would not provide additional assurance as the possibility of such a scenario arising was unlikely. The legal view is that it is extremely difficult to obtain an injunction to stop a payment under a LoC, as they are usually granted only where the bank can show clearly that there is fraud. In such circumstances, it is conceivable (although highly unlikely) that an injunction may be granted to stop payment for the whole amount. However, legal drafting of such letters is not intended to account for fraud of this type. The view was also expressed that it is unlikely that a court would freeze payments in respect of other applicants, because the consolidated LoC indicates clearly that each amount of allocated Credit Cover would be in respect of individual applicants only. As a LoC is a separate contract between the bank and the beneficiary, the bank is required to pay even if applicants have objections, except, if there is an allegation of fraud. Hence, the suggested wording change merely restates the law and would not prevent applicants applying for injunctions on the basis of fraud, and is not, therefore required.

In its assessment of this information, the SSMG considered whether a court was more likely to freeze an entire consolidated LoC over a number of single LoCs. The SSMG concluded that there would be a slightly increased risk of a court freezing a consolidated LoC as there would be for a single LoC.

Robustness:

The SSMG considered the risks associated with a consolidated LoC not being robust and the possibilities for a bank not honouring this type of LoC.

The SSMG noted the advice from the external legal advisor and LoC expert who were both of the opinion that the consolidated LoC was robust. However, the SSMG noted that this advice was based on an untried legal opinion (as P158 would be an entirely new process) with no historical evidence to support the advice. As such, there was no definitive way of confirming the robustness of this type of LoC. Some members of the SSMG were of the view that this reliance on untested legal advice was itself a risk.

Untested process methodology:

The SSMG noted that the proposed consolidated LoC, developed under P158 had never been used before within the electricity industry or any other industry. P158 would therefore introduce an entirely new process for sourcing and lodging Credit Cover.

In light of this, the SSMG noted historical evidence that a consolidated LoC had been used within the Gas industry, by the former company TXU. However, this type of LoC was different to that proposed under P158 as the allocated amounts of Credit Cover were not 'ring-fenced' to individual Parties. This resulted in the entire LoC being called by Transco when one Party within the Group was unable to make payments. This would not be possible under the consolidated LoC, proposed by P158, as each Party covered by a consolidated LoC would be allocated specific 'ring-fenced' amounts of Credit Cover. The SSMG noted that ring fencing was a fundamental part of the Proposed Modification, they were of the view that a consolidated LoC, which did not ring-fence amounts of credit to individual Parties, would lead to additional issues regarding credit checking and default.

In considering this historical information, the SSMG were of the view that a consolidated LoC was still a relatively untested methodology. As such, some members of the SSMG suggested that the new form of LoC could have potentially unidentified risks associated with it. These members were also of the view that the current baseline is a tried and tested method of lodging Credit Cover and is considered robust, whereas the consolidated LoC would be a new process and would involve an inherent risk to the market.

Summary:

In conclusion, the SSMG was split in its decision as to whether P158 would potentially increase risk in comparison to the existing baseline. Half the members of the SSMG accepted the legal opinions that the consolidated LoC was robust and did not believe there was a greater probability for such a LoC to be frozen. However, the second half of the SSMG felt that a consolidated Loc would be a new process, the robustness of which would be based on untested legal opinions, and as such had an associated risk.

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

This section represents a summary of the SSMG's assessment of the Proposed Modification against the Applicable BSC Objectives. The SSMG, in undertaking this assessment, took account of the views expressed by respondents to the Assessment Consultations (see Section 6).

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):

"Promoting effective competition in the generation and supply of electricity and promoting competition in the sale and purchase of electricity"

The following arguments represent the views of the majority of the SSMG in that P158 does 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 facilitating 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 LoC 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 associated with the consolidated LoC. 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.

In addition to the above, the SSMG unanimously agreed that P158 did not better facilitate Applicable BSC Objective (d):

"Promoting efficiency in the implementation and administration of the balancing and settlement arrangements"

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).

Minority view in Support of Proposed Modification

The minority of the SSMG (the Proposer) was of the view that P158 better facilitated the 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.

Conclusion

Further to the SSMG's review of the P158 consultation responses (see section 6) and the additional information provided by external sources (see section 8.1 and Annex 7), 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 potential risks associated with a consolidated LoC. Therefore, the majority of the SSMG believe that P158 does not better facilitate achievement of Applicable BSC Objectives (c) or (d) and as a result should not be made.

1.6 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 COSTS[3]

For the purpose of P158, the SSMG considered two costs associated with who would be responsible for facilitating the role of checking the affiliation. These options were as follows:

- Option 1 - costs associated with implementing P158 with BSCCo undertaking the role of checking the affiliation status of Parties wishing to lodge a consolidated LoC; and
- Option 2 - costs associated with the FAA undertaking the same role (NB: this is the solution which would be implemented under Proposed Modification P158).

These costs are presented below:

[3] Clarification of the meanings of the cost terms in this section can be found in annex 7 of this report

PROGRESSING MODIFICATION PROPOSAL

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

IMPLEMENTATION COSTS – OPTION 1

		Stand Alone Cost	P158 Incremental Cost	Tolerance
Service Provider[5] 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				
	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		Man days 133 £53,200	Man days 78 £31,200	+5%

[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.
[5] BSC Agent and non-BSC Agent Service Provider and software Costs

Total Implementation Cost		£53,200	£31,200	+5%

ONGOING SUPPORT AND MAINTENANCE COSTS – OPTION 1

	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	£ 20,800 per annum	£20,800 per annum	+25% (£5,200)

IMPLEMENTATION COSTS – OPTION 2

		Stand Alone Cost	P158 Incremental Cost	Tolerance
Service Provider[6] 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				
	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		Man days 79	Man days 34	+5%

[6] BSC Agent and non-BSC Agent Service Provider and software Costs

Implementation Resource Cost		£31,600	£13,600	
Total Implementation Cost		£31,600	£13,600	+5%

ONGOING SUPPORT AND MAINTENANCE COSTS – OPTION 2

	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

For the purpose of clarification, the costs associated with BSCCo undertaking the affiliation checking process (option 1) are higher than those costs associated with the FAA undertaking the same role (option 2). This is due to the fact that BSCCo would be required to implement new systems and processes and associated documentation changes to enable it to check the affiliation status of Parties. BSCCo would also have ongoing operation costs associated with this process.

Since its initial Impact Assessment, the FAA have confirmed that it would absorb the costs associated with the affiliation checking process, if it were required to facilitate this role. The FAA have also confirmed that it already has the internal systems in place to check the affiliation status of Parties via 'Companies House' and that this check would not require any additional processes or system changes, as would be required if BSCCo were to undertake the process. In addition, the absorption of this cost would be independent of Modifications P142 and P152 being approved (as indicated in its initial Impact Assessment). Therefore, there are no Service Provider costs indicated.

The SSMG in its assessment of the above costs and acknowledgement of the FAA's agreement to undertake the affiliation checking process, for no additional cost, have concluded that the FAA would be in a better position to facilitate this role.

3 RATIONALE FOR MODIFICATION GROUP'S RECOMMENDATIONS TO THE PANEL

The majority of the SSMG believes that P158 would not better facilitate the Applicable BSC Objectives. Therefore, by a majority, the SSMG makes the following recommendations to the Panel:

- AGREE that the proposed P158 should not be made;
- AGREE a provisional Implementation Date for Proposed Modification P158 (in the event that the Authority determines that Proposed Modification P158 should be made) of 3 November 2004 should an Authority decision be 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;
- AGREE that Modification Proposal P158 be submitted to the Report Phase; and
- AGREE that the draft Modification Report be issued for consultation and submitted to the Panel Meeting of 10 June 2004.

The SSMG's assessment of P158 in terms of Applicable BSC Objectives is contained in Section 1.5 and the rationale for the proposed Implementation Date is contained in Section 8 (below).

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 BSCCo Agent Systems

No impact on BSCCo 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.

4.3 Parties and Party Agents

No impacts were identified on Parties and Party Agents during the Assessment Procedure of P158. Two 'no impact' responses were received to the Detailed Level Impact Assessment and are attached as Annex 5. 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'.

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' has been 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, includes an additional clause, section N9.1.1A, which clarified 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' has been 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 section 1.3.1.2 'FAA Management of Consolidated LoC').
- 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. This amendment would be implemented by the FAA.

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 either the Proposed or Alternative Modification were to be made.

6 SUMMARY OF CONSULTATIONS

6.1 Modification Group's summary of the first consultation responses

A consultation document and questionnaire was issued to the industry on 9 March 2004, with a 16 March deadline for responses. Seven responses (37 Parties) were received and are attached as annex 3 of this report. However, a summary of the consultation responses can be viewed below.

Consultation question	Respondent agrees	Respondent disagrees	Opinion unexpressed
Do you believe Proposed Modification P158 better facilitates the achievement of the Applicable BSC Objectives? Please give rationale and state objective(s)	4 (18)	3 (22)	1 (1)
Do you believe there are any alternative solutions that the Modification Group has not identified and that should be considered? Please give rationale	1 (3)	6 (37)	1 (1)
Do you believe that only affiliated BSC Parties should be able to apply for a consolidated Letter of Credit? Please give rationale	5 (32)	1 (3)	2 (6)
Do you agree that an affiliation checking process is necessary? Please give rationale	6 (37)	1 (3)	1 (1)
Would your company utilise a consolidated Letter of Credit? If yes, Do you believe the opportunity to post a consolidated Letter of Credit would provide a cost benefit to your company? Please give rationale	1 (1) 2 (11)	2 (20) 1 (3)	2 (6)
Do you consider the consolidated Letter of Credit arrangements proposed under P158 would provide a level of protection equivalent to the current requirement for a single Letter of Credit? Please give rationale	5 (21)	2 (19)	1 (1)
Does P158 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure? Please give rationale	1 (5)	5 (32)	2 (4)

The following questions were asked of the respondents and the arguments are summarised below each question.

6.1.1 Applicable BSC Objectives

Four respondents (17 Parties) believed that the Proposed Modification would better facilitate the achievement of the Applicable BSC Objectives (c) in promoting competition and (d) in promoting efficiency. The arguments raised by these respondents were that P158 would reduce the administrative costs associated with lodging several LoCs, thus having a positive impact on competition (c). P158 also promotes efficiency (d) by:

- offering those existing Parties and those entering the market a more efficient mechanism for sourcing Credit Cover;
- reducing the administrative burden on Umbrella Companies lodging several LoCs on behalf of their affiliated BSC Parties; and
- Reducing the Credit Cover monitoring process undertaken by the FAA, as the Parties covered by a consolidated LoC would have the same LoC expiry date and the FAA would only have to notify one company.

Three respondents (22 Parties) did not believe the Proposed Modification would better facilitate the achievement of Applicable BSC Objectives for the following reasons:

- One respondent expressed concerns over the legal drafting of the Consolidated LoC, as there could be a possibility for the lender not to honour the consolidated LoC by exploiting potential loop-holes within the document.
- This respondent also believed that this could expose other market participants to the risk of having to pay the costs of the Parties associated with the consolidated LoC.
- That there would be a decrease in the flexibility of amending LoCs, as these revisions would be carried out by an Umbrella Company and not the individual Parties themselves;
- That P158 would lead to discrimination of other Credit Cover provisions, i.e. cash;
- That the untested methodology of a consolidated LoC could potentially weaken the current LoC process;
- That there was difficulty guaranteeing the robustness of a brand new process; and
- That the risks associated with a consolidated LoC outweighed the potential benefits P158 offered i.e. reduced administrative costs (c) and sourcing LoC more efficiently (d).

One respondent (1 Party) had no comment.

6.1.2 Alternative solutions

One respondent (3 Parties) believed that there was an alternative solution to the Modification Proposal and 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 (see section 1.3.6) and its decision was to rule out the inclusion of cash cover as cash cover could already be lodged by an Umbrella Company and allocated to its affiliated Parties.

Six Respondents (37 Parties) did not believe there was an alternative solution to P158.

One respondent (1 Party) had no comment.

6.1.3 Affiliation versus Non Affiliation

Five Respondents (32 Parties) believed that only affiliated Parties should be able to apply for a consolidated LoC. The arguments for this suggest that:

- It was unlikely that unaffiliated Parties would want to enter such an agreement and even if they were to do so, administratively it would be unwieldy and negate the benefits P158 offers;
- The fact that Parties were affiliated provided more assurance and security to the industry, as the Umbrella Company would have its reputation to consider if any of the affiliates were to go into default; and
- That no financial institute would provide a combined LoC for an arbitrary group of BSC Parties.

One respondent (3 Parties) believed that affiliation was a matter to be decided between the provider of Credit and the relevant BSC Parties. This would not be of any concern to the BSC,

Two respondents (6 Parties) had no comments.

6.1.4 Affiliation checking process

Six respondents (37 Parties) believed that an affiliation checking process would be necessary for P158. One respondent suggested using the process BSCCo currently uses to determine the voting rights for BSC Parties. However, BSCCo confirmed that this would not be suitable for P158 as this electoral list is only updated once a year. Another respondent supported the view of the SSMG that the affiliation checking process should be carried out by the FAA with minimum cost. The FAA have since confirmed that they will be able to facilitate this role with zero costs.

One respondent (3 Parties) was not in agreement with having an affiliation checking process as it was felt that affiliation was a matter between the provider of Credit Cover and the relevant BSC Parties. Therefore, it was of no concern to the BSC.

6.1.5 Usage of LoCs

Three respondents (23 Parties) stated that they would not utilise a consolidated LoC. One respondent suggested that the main benefit of being able to undertake consolidated LoC changes for more than one Party at the same time would not be a significant cost saving for Parties. The same respondent suggested a potential benefit in Parties being able to swap Credit Cover amounts between Parties within the group. However, the consolidated LoC suggested under P158 has specific 'ring-fenced' amounts allocated to each BSC Party and these are considered as separate LoCs. Therefore, credit can not be moved between the Parties and the relevant processes to increase/decrease levels of credit still apply.

One respondent (the Proposer) believed that its company would utilise a consolidated LoC as it would improve the existing process for lodging credit. This respondent further believed that a consolidated LoC would provide reduced renewal costs and allow for less time to be spent on sourcing Credit Cover.

2 respondents (11 Parties) offered qualified support for using a consolidated LoC. Both respondents' arguments welcomed the ability to lodge a consolidated LoC, although they noted that they would not necessarily utilise this at present.

One respondent (1 Party) had no comments.

6.1.6 Risk

Five respondents (20 Parties) believed that a consolidated LoC would provide a level of protection equivalent to that of the current single LoC. One particular respondent (the Proposer), made reference to the external legal advice sought by BSCCo's which clarified that the consolidated LoC was robust and further suggested that it did not foresee any larger risk being caused by the fact that this would require a new process. This respondent also asserted that once a consolidated LoC had been lodged with the FAA, the principle for amending Credit Cover would be exactly the same as would apply for single LoC, because each allocated amount of Credit Cover would be 'ring-fenced'. Therefore, this would not contribute to an increased risk.

Two respondents (19 Parties) did not support the view that a consolidated LoC was as equally robust as a single LoC. The arguments for this were that banks would seek to avoid paying out where they could, and if there was any uncertainty surrounding a LoC they would seek to exploit this to circumvent payment; and it would be difficult to provide a qualified level of assurance as to the robustness of a new process without reference to historical evidence. In the absence of such assurance, it was perceived that the potential benefits of this modification would not justify the creation of a new format for Credit Cover.

One respondent (1 Party) had no comments.

6.1.7 Further Comments

One respondent (5 Parties) suggested that the bank would seek to avoid paying out where they could, and if there is any uncertainty surrounding a LoC they would seek to exploit this to circumvent payment.

One respondent (the Proposer) stated that the current drafting of the Code prevented BSC Parties from lodging a consolidated LoC and that P158 would offer a more efficient process for companies with more than one affiliated Party to lodge credit.

6.2 Modification Group's summary of the second consultation responses

Further to the Panel's decision to send P158 for a further month assessment, a second industry consultation was issued so that participants could review evidence which only became available after the first consultation. In light of this evidence the SSMG requested the views of industry participants on the perceived cost benefits and risks associated with a consolidated LoC.

The second consultation questionnaire was issued to the industry on 20 April 2004, with a 26 April deadline for responses. Seven responses (40 Parties) were received and are attached as annex 3b of this report. However, a summary of the consultation responses can be viewed below.

Consultation question	Respondent agrees	Respondent disagrees	Opinion unexpressed
Do you believe Proposed Modification P158 better facilitates the achievement of the Applicable BSC Objectives (c) in promoting competition and (d) in promoting efficiency? Please give rationale and state objective(s)	3 (12)	3 (27)	1 (1)

Would your company utilise a consolidated Letter of Credit? Please give rationale	1 (1)	3 (27) 2(11) – would not currently use, but might consider in future	1(1)
What is the cost benefit of P158 for your company? Please quantify the cost savings a consolidated Letter of Credit would provide for your company.	3 (13)	2 (17)	2 (10)
i) Do you believe a consolidated Letter of Credit would provide Parties with a suitable level of assurance (taking into account the views which have been expressed as to whether or not a consolidated Letter of Credit would provided a level of assurance equivalent to the existing single Letter of Credit)? Please give rationale.	3 (12)	3 (27)	1 (1)
ii) If you believe a consolidated Letter of Credit would not provide Parties with a suitable level of assurance as compared to the current baseline of a single Letter of Credit, please specify the increase in risk you believe to be associated with a consolidated Letter of Credit?	3 (27)	0	4 (13)

6.2.1 Applicable BSC Objectives

Three respondents (12 Parties) believed that the Proposed Modification would better facilitate the achievement of Applicable BSC Objective (c) in promoting competition and providing cost benefits for Parties. The arguments raised by these respondents were that P158 would:

- Reduce the administrative costs associated with lodging and refreshing several LoCs;
- Provide a more efficient process for lodging and sourcing Credit Cover; and
- Promote competition by providing a more efficient process.

Three respondents (27 Parties) did not believe the Proposed Modification would better facilitate the achievement of Applicable BSC Objective (c) for the following reasons:

- The benefits Parties are expected to gain as a result of P158 are considered negligible and are outweighed by the potential risk to Parties being required to pay a defaulting Parties Trading Charges is a flaw in the consolidated LoC means it is frozen;
- Concern that competition could be diminished by allowing only efficiencies to Parties which are part of a larger group; resulting in smaller players being discriminated against.

Some respondents felt that there was a cost benefit to Parties using the consolidated LoC and therefore P158 better facilitated achievement of Applicable BSC Objective (d), however the SSMG noted the legal view that these benefits should be considered against Applicable BSC Objective (c).

One respondent (1 Party) had no comment.

6.2.2 Usage of LoCs

One respondent (the Proposer) stated that it would use a consolidated LoC as this would improve the existing process for lodging and sourcing Credit Cover. This respondent also believed that the current process was inefficient and resource intensive.

Two respondents (11 Parties) suggested that although there was currently no requirement for their companies to utilise a consolidated LoC, there was a possibility that such a LoC might be considered in the future. However, it is worth noting that one such member was indifferent to this modification.

Three respondents (27 Parties) stated that they would not utilise a consolidated LoC. One respondent suggested that the benefits of this modification were limited. It also suggested that the only main benefit of having a consolidated LoC would be to undertake amendments to Credit Cover amounts at the same time. However, it was noted that this saving would be small. The same respondent commented on the potential benefit of being able to swap Credit Cover amounts between Parties covered by a consolidated LoC. However, the SSMG did consider this option, but concluded that this would be out of the scope of P158, which specified that the Credit would be ring-fenced to individual Parties.

One respondent (1 Party) had no comment.

6.2.3 Cost benefits

Three respondents (13 Parties) suggested that there would be potential cost savings associated with using a consolidated LoC. One respondent (the Proposer) stated that its cost benefits would equate to £11,000 per annum. This figure represents a cost saving by reducing the number of LoCs this company would need to refresh each year (£3,500) and also the decrease in man hours associated with sourcing and lodging Credit Cover (approx £7,500). Another respondent stated that although its company would be unlikely to use a consolidated LoC, it suggested that if it did an estimated £5,000 per annum could be saved. No breakdown of this cost was provided. A further respondent suggested that although its company would not utilise a consolidated LoC, it did provide a small potential cost saving of £500 - £1,000 per annum.

Two respondents (17 Parties) did not believe that P158 would provide any clear cost benefits for Parties. One respondent raised a concern that if a group of Parties were to go into Payment Default, the potential cost to the respondents' company, along with the rest of the industry would be significant should the consolidated LoC prove not to be robust.

One respondent (1 Party) had no comment.

6.2.4 Suitable level of assurance

Three respondents (12 Parties) believed that a consolidated LoC did offer a suitable level of assurance. One respondent stated that there would be no increase in risk to Parties and noted the advice obtained by BSCCo from an external legal advisor and LoC expert, both of whom confirmed that the consolidated LoC was robust. Another respondent also noted this external advice and proposed that the consolidated LoC was sufficiently robust and as workable as the single LoC. A further respondent acknowledged the conflicting views of the two banking sources, but still could not understand how the consolidated LoC would provide less assurance than the current baseline. This respondent also acknowledged the relatively untested methodology of a consolidated LoC, but felt that if this was always the reasoning behind not doing something, there would be a danger nothing would ever get changed.

Three respondents (27 Parties) did not believe that the consolidated LoC proposed under P158 offered a suitable level of assurance. One respondent noted the advice from one banking source that highlighted the potential risk that calling upon a LoC could result in the entire consolidated LoC being frozen. This respondent felt that this would increase the risk on the market. Another respondent highlighted the same advice and suggested that if this risk could not be removed, then this would reduce the level of assurance. However, if this risk was removed, then P158 would provide a suitable level of assurance as the single LoC. A further respondent felt that P158 in comparison to the current baseline would not have same level of assurance.

One respondent (1 Party) had no comment.

6.2.5 Increase in Risk

Three respondents (27 Parties) believed that P158 would increase the risk to Parties and the industry. One respondent believed that an increase in risk was inherent of a new, untested and unproven LoC format over a historically proven and robust single LoC. This respondent noted the opinion of one banking source that had highlighted the risk to industry if an entire LoC could not be called upon. This respondent felt that the materiality of this risk was high. Another respondent proposed that the market had no direct experience of this type of LoC and that this would increase risk. Such risks would outweigh the small benefits P158 had to offer.

4 respondents (13 Parties) made no comment in relation to this question.

6.3 Comments and views of the Modification Group

The SSMG have reviewed responses to two industry consultations (see section 6.1 and 6.2) and the information provided by external sources (Annex 7) in its determination on whether P158 should be recommended to the Panel for approval.

The SSMG noted that the consultation indicated that there would be a limited uptake for a consolidated LoC if P158 were to be approved, and that the respondents supported the SSMG view that P158 should be limited to consolidated LoCs for affiliated Parties only.

The SSMG unanimously agreed that P158 did not better facilitate Applicable BSC Objective (d), by promoting efficiency, as it would not provide central cost savings for BSCCo or the FAA.

The majority of the SSMG concluded that P158 may offer potential administrative benefits for Parties thus promoting Applicable BSC Objective (c). However, this was outweighed by the potential risks associated with a consolidated LoC. Some members of the SSMG agreed with the views of a number of consultation respondents who stated that the consolidated LoC was as robust as the single LoC. However these members still felt that P158 did not better facilitate achievement of the Applicable BSC Objectives as the benefits were limited to a small number of Parties and the uncertainty created by a new form of Credit Cover outweighed the administrative savings. Therefore, the majority of the SSMG believe that P158 does not better facilitate the Applicable BSC Objectives (c) or (d) and as a result should not be made.

7 SUMMARY OF EXTERNAL ADVICE

During the 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

BSSCo'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 (Annex 7). 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 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. This source 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".

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.

8 IMPLEMENTATION APPROACH

The changes required as a result of P158 do impact the BSCCo Agent. The changes do not directly impact BSCCo systems and processes but do require changes to a BSCP. Documentation changes will be managed by BSCCo. The estimated financial cost for implementation of the Proposed Modification is small, with 34 ELEXON man day effort (equating to £13,600) being required to carry out changes to documents etc.

In addition, the SSMG agreed that:

- The Proposed Modification requires changes to the BSCCo Agent process and should be implemented as part of a wider Systems Release as the most cost-effective and efficient approach, since it avoids incurring the full costs of a stand-alone Release;
- This approach is consistent with BSCCo's Release Strategy.

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 2004 if an Authority Decision is received after this date but on or before the 12 November 2004.

8.1 Authorities

Version	Date	Author	Reviewer	Change Reference
0.1	29/03/04	Change Delivery	SSMG	For review
0.11	31/03/04	Change Delivery	Change Delivery	For Review
1.0	02/04/04	Change Delivery	Panel	For Determination

8.2 References

Ref	Document	Owner	Issue date	Version
1	P158 Modification Proposal	ELEXON	27 January 2004	1.0
2	P158 Initial Written Assessment	ELEXON	12 February 2004	1.0
3	P158 Assessment Report Version 1.0	ELEXON	3 April 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	28/04/04
Thomas Bowcutt	ELEXON (Chairman)	Y	Y	Y	N	Y
Roger Salomone	ELEXON (Chairman)	Y	N	N	Y	N
Michelle Spurden	ELEXON (Lead Analyst)	Y	Y	Y	Y	Y
Mark Manley	BGT (Proposer)	Y	Y	Y	Y	Y
Carl Wilkes	Npower	Y	Y	Y	Y	Y
Helen Bray	London Electricity	Y	Y	N	N	Y
Man Kwong Liu	Scottish Power	Y	Y	Y	N	Y
Neil Smith	Powergen	Y	Y	Y	Y	Y
Phil Russell	Not Applicable	Y	N	N	N	N
Steve Drummond	EDF Trading	Y	Y	N	N	Y
Joanne Ellis	Cornwall Consulting	N	N	N	N	N
Kevin Rendell	NGT	Y	N	N	N	Y
Martin Wiles	Logica CMG EPFAL	N	Y	Y	N	N
Thomas Wood	Logica CMG EPFAL	N	Y	Y	Y	N
Paul Davis	Logica CMG EPFAL	N	N	N	Y	N
Steve Mackay	Ofgem	N	Y	Y	Y	N
Jerome Williams	Ofgem	N	N	N	N	Y

ANNEX 3 CONSULTATION RESPONSES

Responses from P158 Assessment Consultation 1 and 2 – see Attachment 2

ANNEX 4 BSC AGENT IMPACT ASSESSMENTS

<table>
<tr><td colspan="2" rowspan="2">NETA Change Form</td><td>ELEXON Reference</td></tr>
<tr><td>P158</td></tr>
<tr><td colspan="2">Title</td><td>Version No.</td></tr>
<tr><td colspan="2" rowspan="3">Introducing the ability to lodge a consolidated Letter of Credit'</td><td>version, 1.0</td></tr>
<tr><td>EPFAL Reference</td></tr>
<tr><td>P158/credit</td></tr>
<tr><td>Type of Assessment</td><td>Date CP Received</td><td>Date IA Issued</td></tr>
<tr><td>DLIA / Quotation</td><td>26/03/04</td><td>3/3/04</td></tr>
<tr><td colspan="3">Brief Summary of Change</td></tr>
<tr><td colspan="3">P158 seeks to modify the Balancing and Settlement Code to allow a group of BSC Parties to lodge a single consolidated Letter of Credit (LoC).</td></tr>
<tr><td colspan="3">Logica EPFAL's Proposed Solution</td></tr>
<tr><td colspan="3">The FAA can accommodate the proposals captured in P158 for a consolidated Letter of Credit as the number of Parties it is likely to impact will be minimal.

The FAA would propose carrying out the affiliation checks internally as it can't see any benefit to BSC Party's in fragmenting the process and the FAA has the resource available to carry out the necessary checks.</td></tr>
<tr><td colspan="3">Deviation from ELEXON's Solution / Requirements</td></tr>
<tr><td colspan="3">No deviation from the proposal other than recommending the FAA carries out the affiliation checks . Cosmetic changes will be required to BSCP301.</td></tr>
<tr><td colspan="3">Operational Solution and Impact</td></tr>
</table>

To accommodate affiliation checks.
Testing Strategy

Unit		Change Specific		End to End	
Module		Operational Acceptance		Participant Testing	
System		Performance		Parallel Running	
Regression		Volume		Deployment/ Backout	
Other:					

N/A
Validated Assumptions
N/A
Outstanding Issues
N/A
Changes to Service
Services Impacted *[Tick boxes to show impacted systems and associated documentation]*

	Funds Transfer System	Other 1	Other 2
Software			
IDD Part 1			
IDD Part 2			
URS			
SS			
DS			
OSM			
RTP			

Comms	
Other	

Nature of Documentation Changes
Cosmetic changes to BSCP301, no impact upon on the FAA service Description, URS, IDD. *If the proposal to add a BSCCo process to verify that the BSC Parties on c consolidated LoC are affiliated, this might require changes to the FAA Service Description, URS and IDD in order to include the BSCCo every time a new consolidated LoC is submitted.*
Nature / Size of System Changes
NA

Type of Release Costed:	*Patch*
Deployment Issues, eg Outage Requirements:	*N/a*
Impact on Service Levels:	*No impact on service levels*
Impact on System Performance:	*No impact on service levels*

Responsibilities of ELEXON		
Confirmation of agreed proposal adopted		
Acceptance Criteria		
N/A		
Any Other Information		
N/A		
Attachments		
PRICING		
Price Breakdown		
Item description	**Remarks**	**Price (ex VAT)**
Change Specific Cost		
Project Overhead		
[Price excluding VAT]		
Project Duration		
Operational Price (eg per annum or event)		
Rationale		
Providing the cost of implementing P142 and P152, can be met the FAA can undertake the above Modification for no extra cost.		
Annual Maintenance Price		*A.1.1.1*

Rationale	
N/A	
Validity Constraints	
N/A	
Authorised Signature	**Date Signed**

ANNEX 5 PARTY IMPACT ASSESSMENTS

Respondent 1:

MC00080: High Level Impact Assessment of P158

Please provide responses to the following questions:

1. Would any of the Proposed Modification implementation options, as outlined in the attached Requirements Specification, impact your organisation? ~~Yes~~/No*

2. If yes, please indicate which of the options would impact your organisation and provide a brief description of the impact, any costs incurred, and the implementation timescale required:

3. Any other comments:

Name: ________Saeed Patel___________________________________
BCA/~~PACA~~* _________BCA________________________________
Organisation: _______EDF Trading Limited___________________________________
Date: ___11th March 2004_________________

*Please delete as appropriate

Respondent 2:

MC00080: High Level Impact Assessment of P158

Please provide responses to the following questions:

4. Would any of the Proposed Modification implementation options, as outlined in the attached Requirements Specification, impact your organisation? **NO**

5. If yes, please indicate which of the options would impact your organisation and provide a brief description of the impact, any costs incurred, and the implementation timescale required:

6. Any other comments:

Name: **Sue Macklin**
BCA/PACA*
Organisation: **Scottish and Southern Energy; Southern Electric; Keadby Generation Ltd; and SSE Energy Supply Ltd.**
Date: **16th March 2004**

*Please delete as appropriate

ANNEX 6 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. In order to give Stakeholders a feel for the estimated cost of implementing an Approved Modification the templates shown in Attachment 1 have 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 Procedures.

SERVICE PROVIDER[7] 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 Costs	Any short-term resource requirements in addition to the ELEXON resource available. For CVA BSC Systems Releases, this is typically only necessary if the proposed solution for a Modification Proposal would require more extensive testing than normal, procurements or 'in-house' development. For SVA BSC Systems Releases, this will include the management and operation of the Acceptance Testing and the associated testing environment. This cost relates solely to the short-term employment of contract staff to assist in the implementation of the release.
Additional Testing and Audit Support Costs	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 at tolerance of +/-25%. For SVA BSC Systems

[7] 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.

	Releases this is estimated on a Modification Proposal basis.

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	
ELEXON Operational Cost	Cost, in man days per annum multiplied by project average daily rate, of operating the revised systems and processes post implementation.
Service Provider Operation Cost	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.
Service Provider Maintenance Cost	Cost quoted in £ per annum payable to the Service Provider(s) to cover the maintenance of the amended BSC Systems.

ANNEX 7 TERMS OF REFERENCE AND REPORT/ANALYSIS OF EXTERNAL CONSULTANTS/ADVISORS

7.1 SSMG Terms of Reference

Modification Proposal P158 will be considered by the Settlement Standing Modification Group (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;

- **<u>Default</u>** – Issues may arise from having a consolidated LoC under different Default circumstances, for example:

  i <u>Default under the Code:</u> 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 <u>Payment Default:</u> 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 <u>Credit Default:</u> 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 <u>Status of BSC Parties:</u> 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.

- **<u>Withdrawal of a Party from a consolidated LoC</u>** – 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.

- **<u>Application to LoCs Only</u>** – 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

- **<u>Legal / Commercial Issues</u>** – 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.

- **<u>Costs/benefits</u>** – The Modification Group should assess the costs savings to Parties of using a consolidated Letter LoC.

7.2 Banking Source's Opinion of P158

The information supplied in this document has been provided by an external financial establishment ("the source"), which can not be named for legal reasons. The following information provides an external banking opinion (the source wanted to make it clear that this is not a legal opinion) on the robustness of the draft consolidated Letter of Credit, as supplied by ELEXON.

The source sought Specialist Support advice regarding the wording of the draft consolidated Letter of Credit (LoC), in order to find out whether a similar document had been seen before or whether such a document could have been potentially agreed by the British Bankers Association. Neither of which were confirmed. However, the wording of the draft consolidated LoC was considered workable, but the following points were raised by the source:

1. Whilst it would be possible to issue a standby on behalf of multiple applicants it could potentially cause problems from an operational point of view in that the lender could only record a liability against one name. To record against multiple names, covered by a consolidated LoC, the lender would need to open a separate instrument for each applicant to record their portion of the overall liability. The lender would also need to have a 'base' file which would be the actual instrument that the lender would issue and all of these files would need to be cross referenced. Due to the extra work involved and greater potential for errors the source suggested that it would prefer to steer clear of this type of document.

2. In the event of a claim against one of the applicants, it would be possible for another applicant to obtain a court injunction to prevent the bank from paying. Although the source deemed this unlikely, it proposed that any lender would be obliged to act in accordance with the terms of any Court Order, even if it were to 'freeze' the entire standby.

3. The wording of the draft LoC states that the standby could be claimed against should the lender not extend or replace it in accordance with the underlying Balancing and Settlement Code, or if the lender was to fall short of the required credit rating as detailed in the same Code. The source clarified that it had no knowledge of the Code and subsequently warranted this aspect to be a separate and independent consideration from the standby. The source asked ELEXON to appreciate the fact that the beneficiary could present claims for these reasons even if the applicant(s) was not in default, which the lender would be obliged to pay. Therefore, Specialist Support have suggested that ELEXON may wish to satisfy itself with the acceptability, or otherwise, of the terms of the Balancing and Settlement Code, before it can agree to this point.

4. Specialist Support have drawn attention to the 'set-off' clause and have stated that this could deprive the bank of certain rights.

5. The clause relating to UCP must state that it is ICC Publication No. 500.

7.3 Counter Opinion to that of the Banking Source

BGT in their response to the assessment consultation stated that they had spoken to a financial institution that confirmed they would be happy to provide a consolidated LoC under the format proposed. They have put this in writing and were fully aware of the concerns expressed by the other financial institution.

"Further to our telephone conversation on 29.3.04, we are in principle agreeable to issuing a standby LC in the attached format."

Also we have gained an internal legal view on the concerns expressed by the source and they are as follows:-
"(i) It is envisaged that the vast majority of LC's covering multiple BSC Parties will be covering parties who are affiliates and subsequently share information. As such, there would be no more likelihood of such applicant obtaining a court injunction than at present where affiliates have separate LC's.

(ii) The probability of a court granting an injunction to prevent payment does not increase for such multi party LC, the court would still only be concerned with whether the pre-requisites of such demand were met.

(iii) If this is of specific concern, which is not our view, the LC could be amended simply to the effect that; "the bank has an obligation to pay, notwithstanding any objection from a multiple applicant"."

