Modification Proposal

MP No: 140
(mandatory by BSCCo)

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

Revised Credit Cover Methodology for Interconnector BM Units

Submission Date *(mandatory by proposer)*: 21st August 2003

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

The proposal is to modify Section M 1.5 of the BSC for Interconnector Users (IUs) only, such that the values of Credit Assessment Credit Energy Volume (CAQCE) for each Interconnector BM Unit (I-BMU) are made equal to the FPN data, rather than trying to estimate an energy volume based on past trading activity. It would avoid the need to use or determine an I-BMU's CALF, GC and DC parameters for the Credit Energy Indebtedness (CEI) calculation.

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

This modification seeks to address the anomalous treatment for Interconnector Users in the way the CEI is calculated for the I-BMUs, which at present is based on historical data that has little relevance to current or future trading activity.

The amount of Credit Cover needed by an Interconnector User for its I-BMUs can be very variable. This is not because of the risks posed by IUs to the rest of the market, but because of the particular methodology used for determining CAQCE in the CEI calculation (see Attachment 1 for an expansion of the calculation).

Central to the CEI calculation is the use of the Credit Assessment Load Factor (CALF), as well as Generation Capacity (GC) and Demand Capacity (DC), but for Interconnector Users these values have little (if any) relevance, other than to cause unnecessary credit cover volatility. Their use requires the need for frequent monitoring of CEI and for very flexible credit cover arrangements to enable the required amounts to be posted quickly. The large amounts that can be required can cause significant additional and unnecessary costs.

The proposal would replace CAQCE with the I-BMU's FPN data, which is considered more appropriate in this instance because of the specific auction and/or trading rules that dictate an IU's behaviour in the market.

The past trading volumes and past values of GC and DC, as well as the maximum half hourly figure, often bear no relation to what a particular I-BMU might be currently trading or indeed what might be expected at any time in a forthcoming BSC Season. Such volumes will actually depend on the capacity obtained on the interconnector and the price differentials exhibited in the interconnected markets for the period in question.

The inappropriateness of these parameters to I-BMUs has been recognised for some time by a number in the market, including the ISG and the SSMG who have been considering how the problem can be adequately addressed. The SSMG at the meeting dated 16th July 2003 agreed that Interconnector Users were different from other Parties as the net position of their Final Physical Notification data for their BMUs would be equal to their Deemed Metered Volumes and, as such, there was merit in a Modification Proposal whereby the FPN data for I-BMUs only was used as the CAQCE in credit calculations.

In the case of the Anglo-French Interconnector (although similar arrangements exist for the Anglo-Scottish Interconnector), IUs submit their Physical Notification (PN) of the net transfer (import or export as appropriate) for each half hour by 1pm on the day ahead to NGC. All the individual Contract Notifications (CN) for the I-BMU, that equate to the PN, are submitted to Central Systems soon afterwards. These roll forward to become the FPNs. NGC acts as the Interconnector Administrator in this instance and checks that

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the PN data is consistent with the Interconnector capacity booked to that Party. If it is higher than the booked capacity, it is flagged to the Party for it to correct or it will be scaled back accordingly. Once notified, the IU will deliver that transfer and this is recognised by the Interconnector Administrator (in this instance RTE in France) submitting DMVs for parties which will equal the PN data, except for errors due to transmission losses or if the interconnector capability is reduced for some reason. An IU cannot fail to fulfil it's I-BMU obligations as given through its contract notifications, except in cases of plant failure, instances of which have been very few historically (typically, interconnector availability figures including planned outages are greater than 97%. Therefore, the risk to the market is small and, under normal circumstances, it would be expected that the credit risk would be close to zero, since the planned and actual volumes are virtually the same. Under exceptional circumstances eg system/Interconnector faults, the exposure would be limited at most to a small number of hours for the volumes being traded. Despite this reality, and instead of treating I-BMUs as a low credit risk, the current methodology assigns them a very low CALF that requires a high proportion of their trades to be substantially underwritten.

The proposal is to gain fair treatment for IUs and their I-BMUs which, it is contended, would not be unduly discriminatory in this case. All IUs would be given equal treatment, the credit cover required would be at an appropriate level and at a level that more adequately reflects the risks posed to the market than at present.

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

The proposal seeks the amendment of Para 1.5 of Section M of the BSC to include special provisions for Interconnector BM Units and for consequent changes to be made to the CALF Guidelines.

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

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

The CEI calculation would need to pick up the summation on the FPN data for each I-BMU, rather than the relevant CALF and GC/DC values. Reports of CALF and GC/DC values for Interconnector Users could be nullified and there would no longer be a requirement to collect them from the IUs.

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

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

Putting up letters of credit to cover the potential risks to the market is understood and accepted. The difficulty comes when the perceived risk, due to a particular method of calculation, is much higher than reality. The problem is then compounded when that methodology is such that the CEI value can go extremely high for trading conditions that are very likely to occur and can occur very quickly. By amending the current credit cover methodology for Interconnector BM Units as proposed, it would remove an unfair financial burden being put on current and potential IUs and it would represent a better reflection of the trading risk posed by the IUs on the market. The proposal would reduce costs to parties and hence ease trades between the E&W market and the markets of neighbouring systems, as well as helping to avoid unnecessary credit cover being posted. It would therefore meet Applicable BSC Objectives (c) and (d).

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Attachments: Yes

If Yes, Title and No. of Pages of Each Attachment:

Use of CALF and GC/DC in the Energy Indebtedness Calculation – 1 Page

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