



August 2003

**Definition Consultation: P132-
'Redefinition of Credit Cover
Requirements to account for
Reconciliation Charges'**

**This report outlines the discussions and initial findings
of the SSMG during Definition Procedure for P132 and
is issued to support Industry Consultation**

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I DOCUMENT CONTROL

a Authorities

Version	Date	Author	Signature	Change Reference
0.1		Change Delivery		
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Version	Date	Reviewer	Signature	Responsibility
0.1		Change Delivery		Review
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Version	Date	Approver	Signature	Responsibility
1.0		Roger Salomone		

b Change History

Version 0.1 was issued for review

Version 1.0 incorporates review comments and is issued for industry consultation.

c Related Documents

Reference	Document
Reference 1	Modification Proposal P132- 'Redefinition of Credit Cover Requirements to account for Reconciliation Charges'
Reference 2	Initial Assessment Of Modification Proposal P132- 'Redefinition of Credit Cover Requirements to account for Reconciliation Charges'' (P132IR)
Reference 3	P132 Consultation Pro-forma

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1 INTRODUCTION

1.1 Background and Scope

Modification Proposal P132 'Redefinition of Credit Cover Requirements to account for Reconciliation Charges' (P132) was raised by TXU Direct Sales Limited on 19 June 2003. P132 proposes to redefine Credit Cover Requirements to account for Reconciliation Charges, Trading Disputes and Past Notification Error (PNE) claims in order to ensure that credit is retained for a withdrawing or withdrawn Party to ensure future Settlement liabilities can be met.

Under the existing arrangements a Party may reduce its Credit Cover to the Minimum Eligible Amount (MEA) as defined in Section M 2.3.2 of the Code as follows:

"the "minimum eligible amount" is the lowest amount for which the Trading Party's Credit Cover Percentage, if it were redetermined for each Settlement Period in the waiting period on the assumption that the Trading Party's Credit Cover were equal to that amount, would be not greater than 75% in relation to any such Settlement Period."

A Party's Credit Cover Percentage is the ratio of its Energy Indebtedness to its Energy Credit Cover. Energy Indebtedness is an estimation of the energy traded by the Party over the last 29 Days. Currently the calculation of Energy Indebtedness does not account for any potential changes following Reconciliation Runs and rectification of Trading Disputes or Past Notification Error (PNE) claims. Hence the MEA for any Party which has not traded for 29 days will be zero.

As specified in Section A 5.1.3 a Party may not withdraw from the Code until several criteria have been fulfilled and these include:

(b) the Final Reconciliation Settlement Run has not been carried out in relation to the last Settlement Day, or the corresponding Payment Date is not yet past.

Therefore, a potential scenario exists whereby a Party ceases trading but is still registered in the Code, 29 days later the Party will be able to reduce its Credit Cover to zero (as its Energy Indebtedness for the last 29 days will be zero). However, the Party may still be liable to pay Trading Charges associated with Reconciliation Runs and rectification of Trading Disputes or PNE claims for Settlement Days for which it was trading. Following the 29 day period after the last Settlement Day for which the Party has traded any Trading Charges not paid by the Party would potentially have to be recovered via legal action.

P132 seeks to modify the methodology for calculating the Minimum Eligible Amount such that a Party which is no longer trading, or has withdrawn from the Code, will be required to maintain Credit Cover against potential liabilities relating to Reconciliation Runs, Trading Disputes or PNE claims.

The IWA for P132 was presented to the Balancing and Settlement Code Panel (Panel) on the 10 July 2003. The IWA highlighted several issues that required further definition. Therefore it was agreed that P132 should be submitted to a 2-month definition procedure to be conducted by the Settlement Standing Modification Group (SSMG).

The Definition Procedure Terms of Reference considered by the SSMG are as follows:

- **Form of the new Credit Cover obligation;**
- **Estimation of Potential Liabilities;**
- **Interaction between PNE claims process and P132 Modification Procedures.**

1.2 Purpose and Structure of Document

The primary purpose of this document is to outline the definition issues surround P132 and to detail the findings of the SSMG during the Definition Procedure, in order to support industry consultation.

The document is structured as follows:

- Section 2 Summarises P132 as defined by the SSMG at this time.
- Section 3 Outlines the discussions and rationale behind the findings of the SSMG to date and recommended way forward.

2 SUMMARY

2.1 SSMG Proposed Recommendations

The following issues have been considered by the SSMG during the Definition Procedure to date:

- **Form of the new Credit Cover obligation**
- **Estimating Potential Liabilities**
 - Reconciliation Runs
 - Trading Disputes
 - PNE Claims

Having considered the key issues above in detail, the SSMG agreed the definition of P132 included in section 2.2 of this document. The detailed discussion and rationale leading to these conclusions is given in section 3.

In light of the issues outlined in section 2.2, it is the view of the SSMG that it is not possible to define how potential Reconciliation and Trading Dispute claim liabilities should be estimated under P132. The SSMG also perceive the risk associated with the Reconciliation charges of a withdrawing Party as relatively minor.

Therefore it is the current view of the SSMG that, following completion of the Definition Procedure, P132 should be sent straight to report with the recommendation to reject. Views on this approach are sought via industry consultation.

2.2 Definition of Modification Proposal

This section summarises P132 as defined by the SSMG at this time.

If approved P132 would introduce new Credit Cover arrangements which would:

- Not change the existing Credit Cover arrangements for Parties continuing to trade;
- Require a Party wishing to withdraw from the Code to notify BSCCo on the discontinuation of Trading Activity;
- Require that BSCCo be informed of any Parties making significant reductions in their Credit Cover;
- Require BSCCo to, on notification of a Party's intent to withdraw from the Code, to calculate an amount of Credit Cover to be posted by such withdrawing Party;
- Include in the calculation of the Credit Cover required by a withdrawing Party potential liabilities resulting from future Reconciliation Runs, existing Trading Disputes and PNE claims;
- Require a withdrawing Party to post the amount of Credit Cover calculated by BSCCo;
- Require this Credit Cover to be retained until all Reconciliation Runs, Trading Disputes and PNE claims included within the calculation of the amount had been processed.

This definition is based on the discussions of the SSMG to date and will be review in light of responses to industry consultation.

3 SSMG PROVISIONAL FINDINGS

This section details the findings of the SSMG during the Definition Procedure to date.

3.1 Form of the new Credit Cover obligation

The Modification Proposal was not specific on the changes required to the Credit Cover methodology which would ensure that a Party pays all their bills prior to withdrawal from the Code. The SSMG have considered how the revised Credit Cover arrangements would function under P132 and have agreed the following approach:

1. Party ceases trading activity and notifies BSCCo of its intention to withdraw from the Code;
2. BSCCo calculates the Credit Cover required to cover potential liabilities arising from Reconciliation Charges, Trading Disputes and Past Notification Error (PNE) claims (see section 3.2);
3. Withdrawing Party posts Credit Cover as calculated by BSCCo;
4. This Credit Cover is maintained until all Reconciliation Runs, Trading Disputes and PNE claims included within the calculation have been processed.

These arrangements would have no impact on the existing Credit Cover arrangements for Parties continuing trading activity.

The SSMG recognised that this approach relies on the Party notifying its intent to withdraw. Therefore, a requirement for ECVAAs to notify BSCCo of any Parties making material reductions in their Credit Cover would be introduced.

3.2 Estimating Liabilities

The SSMG have considered the approach to estimating the liabilities of a withdrawing Party arising from Reconciliation Runs, Trading Disputes and PNE claims under P132 as outlined in this section.

3.2.1 Reconciliation

The SSMG considered the Reconciliation Trading Charges of a withdrawing Party, as detailed in the analysis contained in Annex 1.

The analysis indicated that there was potential for Reconciliation Trading Charges to sum to a significant amount during the extended timescales for withdrawal from the Code. However, it also indicated that it is not possible to predict whether these Trading Charges would result in a net payment to the Party, or whether there will be a payment made by the Party as the net Trading Charges can be either positive or negative. It was the view of the SSMG that this highlights the difficulty with trying to account for Reconciliation in the Credit Cover arrangements.

If the average Reconciliation Trading Charge across the market were considered then the amount would be zero. However, the purpose of retaining Credit Cover is not to protect against the average case, rather to protect against the worst case scenario where an individual Party accumulates significant liabilities which are unsecured. The only way this

could be done for Reconciliation charges would be to estimate the amount for the worst case scenario and require the withdrawing Party to cover that. On average this would mean withdrawing Parties would be required to hold a significant amount of Credit cover to protect against Reconciliation risk. It was the view of the SSMG that this would significantly increase the costs of leaving the market, which could ultimately prove a barrier to Parties entering the market (i.e. Parties will not only consider how costly it will be to enter the market but how costly it would be to leave should it not work out).

In light of the above the SSMG agreed that it is not possible to produce a meaningful estimation of the Credit Cover required to protect against Reconciliation risk. In fact it was agreed that the most appropriate estimation may be zero as required by the current arrangements.

3.2.2 Trading Disputes

The SSMG recognised that calculating the materiality liabilities relating to Trading Disputes would be complicated due to the timescales involved in the Trading Disputes process (Under Approved Modification P107-“Data Retention Requirements for Post-Final Trading Disputes” Trading Disputes can be raised up to 20 months after the Settlement Day).

For Trading Disputes which had been considered and accepted by the TDC an estimate of the materiality would be known. Therefore it was agreed by the SSMG that potential liabilities arising from those Trading Disputes considered and accepted by the TDC would be included in the amount of Credit Cover required by a withdrawing Party under P132.

This approach would not protect against liabilities resulting from Trading Disputes raised after the calculation of the amount of Credit Cover to be posted by the withdrawing Party. Trading Disputes impacting the Party could be raised for up to 20 months after the last Settlement Day for which the Party was trading. It is not obvious that the number or materiality of such Trading Disputes could be predicted. Therefore, it was the view of the SSMG that no meaningful estimation of the liabilities arising from these potential future Trading Disputes could be made.

3.2.3 PNE Claims

P132 seeks to oblige a withdrawing Party to place Credit cover for PNE claim liabilities. Therefore, the SSMG have considered the schedule for processing PNE claims and the time scales for progressing P132 in order to determine whether PNE claims would be processed prior to any potential implementation date for P132.

The last of the PNE claims relates to 8 April 2002, therefore if it is possible to catch up with the Settlement Runs, all upheld claims will be rectified by 9 April 2004. Current understanding indicates that it will be possible to catch up on the Settlement Timetable by running a number of runs a day. In the worst case scenario, where it is not possible to catch up on the Settlement Timetable, the latest date for rectification of PNE claims would be December 2004.

The P132 Definition Report will be considered by the Panel in September 2003. Should the Panel determine that the Modification is to be progressed further it is likely that a two month Assessment Procedure would be required (i.e. Assessment Report to the Panel November 2003). The Draft Modification Report would then be considered by the Panel in December 2003 and the finalised version would reach the Authority by January 2004, the

Authority would then require a period of time to consider the Modification prior to making its determination.

Therefore, as the Modification would require ECVA System changes in order to implement any changes to the Credit Cover arrangements (and hence a seven month lead time), the earliest realistic implementation date for P132 would be November 2004.

The SSMG have considered the above and recognised that it is probable that all existing PNE claims will have been processed prior to any realistic implementation date for P132. However, the approach agreed by the SSMG would allow PNE claims to be included in the calculation of the Credit Cover amounts required for a withdrawing Party (if all claims had been processed the PNE contribution would be zero). This approach would also allow flexibility for any future PNE claims raised to be considered, for example as proposed by P128-“Correction of Erroneous Energy Contract Volume Notifications in Specifically Defined Limited Circumstances”.

The estimated materiality of existing PNE claims is known and could be used in the calculation of the Credit Cover amount required by a withdrawing Party under P132.

3.2.4 Provisional Recommendations

This section outlines the initial conclusions of the SSMG and resulting provisional recommendations. Following industry consultation these will be finalised and presented to the Panel at its meeting 11 September 2003.

Provisional findings of the SSMG relating to P132:

- 1. It is not possible to define how potential Reconciliation and Trading Dispute claim liabilities should be estimated.**
- 2. Reconciliation Trading Charges can be either negative or positive, therefore the current arrangements, requiring zero Credit Cover is retained for Reconciliation Runs, is as meaningful as any alternative.**
- 3. Requiring Credit Cover to be retained by withdrawing Parties is a barrier to entry.**
- 4. As a consequence P132 would not better facilitate the Applicable BSC Objectives.**

Therefore, the provisional recommendation of the SSMG is that P132 be sent to the report phase with a recommendation to reject the Modification Proposal.

ANNEX 1: CASE STUDY -TRADING CHARGES OF A WITHDRAWING PARTY

This section contains analysis of the Trading Charges of a large Supplier which had ceased trading and was in the process of withdrawing from the Code. Analysis was based on the Trading Charges generated for payment dates in an 8 month period following discontinuation of trading activity. This information was provided in order to assist the Settlement Standing Modification Group in their assessment of the materiality of Reconciliation Trading Charges generated by a withdrawing Party.

This section summarises results of the analysis of Trading Charges as illustrated in Graphs 1 to 8.

- **Chart 1: Trading Charge balances**

Chart 1 illustrates both the total balance of Trading Charges and a break down by run type. In this example Trading Charges generated at SF result in a positive balance (payment from the Party) of £2,755,221. Trading Charges generated from Reconciliation Runs result in a negative balance of -£1,064,250 (payment to the Party). Consequently the overall position, for the 8 month period considered, was a positive balance of £1,690,972.

- **Chart 2: Trading Charge Payments**

Chart 2 shows the Trading Charges generated from individual Reconciliation Runs. Trading Charges generated from SF runs were typically an order of magnitude larger than non-SF values and have been excluded from the chart for clarity (see Tables 1 and 2 for details of SF Trading Charges).

The largest SF Trading Charge observed was a payment from the Party of £493,965. The largest Reconciliation Trading Charge was a Payment to the Party of -£36,710.

- **Chart 3: Positive Negative Run Type split**

Chart 3 illustrates the split between positive and negative Trading Charges for each run type. The chart shows a swing from a 96% majority of payments from the Party for SF runs to a 9% minority for RF runs.

- **Chart 4: Fraction of Trading Charges by volume.**

Chart 4 shows the fraction of the total Trading Charges (absolute values), by cash volume, generated by each Run type within the 8 month period. The chart illustrates that 56% of Trading Charges were generated via SF Settlement Runs.

- **Chart 5: Fraction of positive trading charges by volume**

Chart 5 shows the fraction of positive Trading Charges (i.e. payments from the Party), by cash volume, which were generated by each run type within the 8 month period. The chart illustrates that 81% of the payments from the Party were generated via SF Runs.

- **Chart 6: Fraction of negative trading charges by volume**

Chart 6 shows the fraction of negative Trading Charges (i.e. payments to the Party), by cash volume, which were generated by each Run type. The chart illustrates that 6% of the payments to the Party were generated via SF Runs.

- **Charts 7 and 8: Average Trading Charges.**

Charts 7 and 8 show the average Trading Charges for each run type (Graph 8 contains a subset of the data from Graph 7 with SF values removed for clarity).

The average SF Trading Charges is £76,533.93. The average of the absolute SF Trading Charges is £83,159.45.

The average Reconciliation Trading Charges is -£1,627. The average of the absolute Reconciliation Trading Charges is £3,659.

- **Further Points**

Tables 1, 2 and 3 contain a selection of the raw data from which Charts 1-7 were derived. This data illustrates a further point of interest as follows.

Although the average Trading Charge associated with Reconciliation Runs is much lower than that for SF runs (see Charts 7-8), due to the Settlement timetable, a withdrawing Party will be liable to significantly more Reconciliation Runs than SF Runs. In the example 690 Runs were considered of which 654 were Reconciliation Runs. Hence Reconciliation Charges may have a significant contribution to the overall balance position of a Party in the process of withdrawing from the Code.

Chart 1:

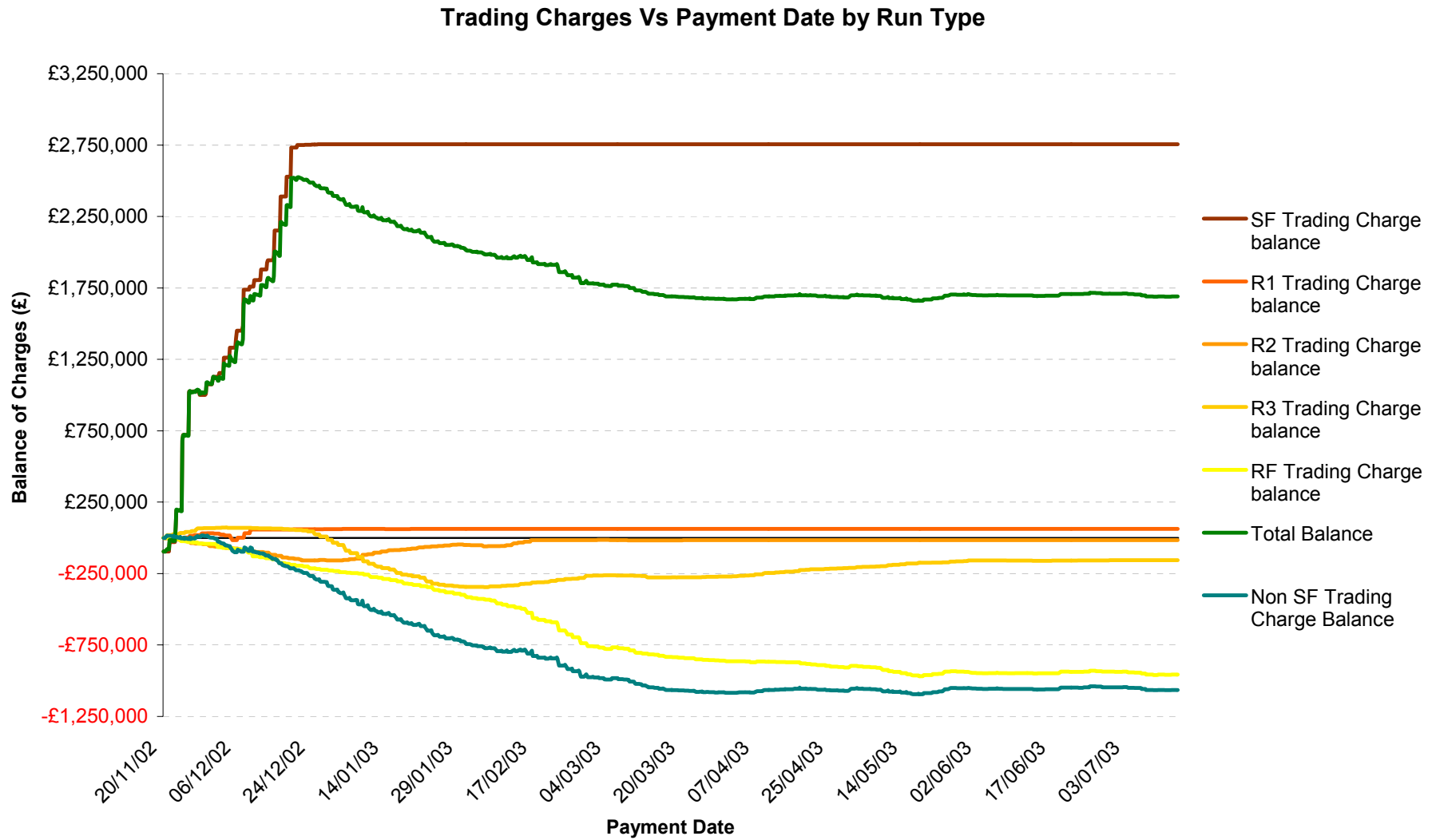


Chart 2:

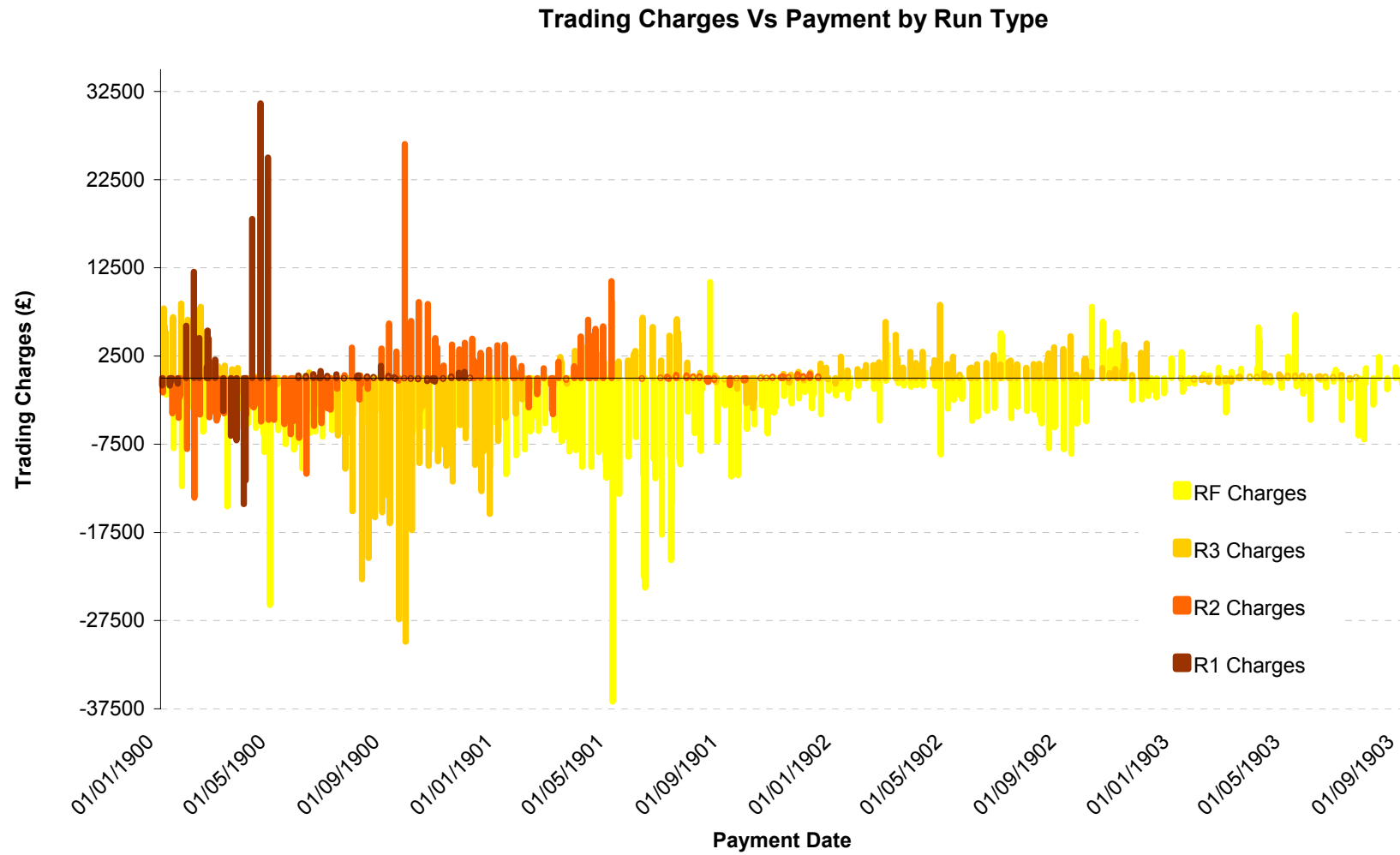


Chart 3:

Positive/ Negative Charge Split Vs Run Type by Volume

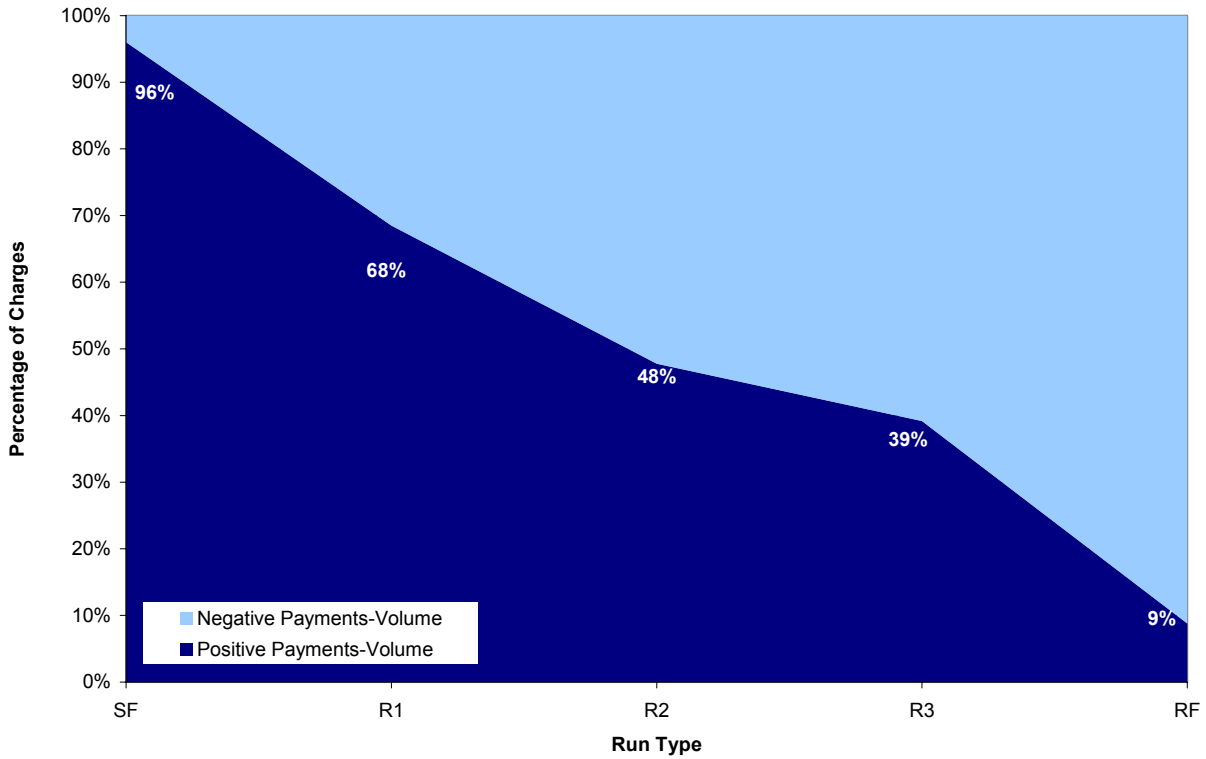


Chart 4:

Fraction of Total Trading Charges Vs Run Type by Volume

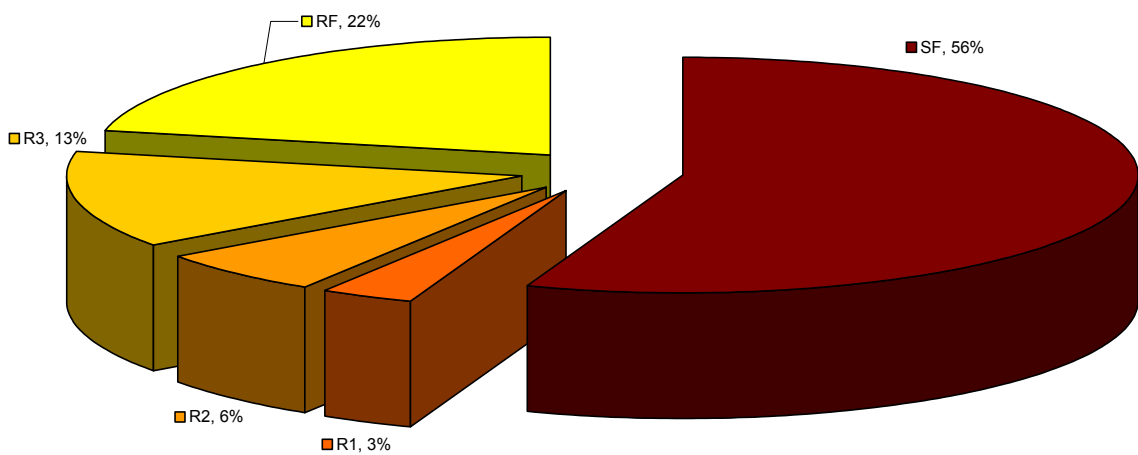


Chart 5:

Fraction of Positive Trading Charges Vs Run Type by Volume

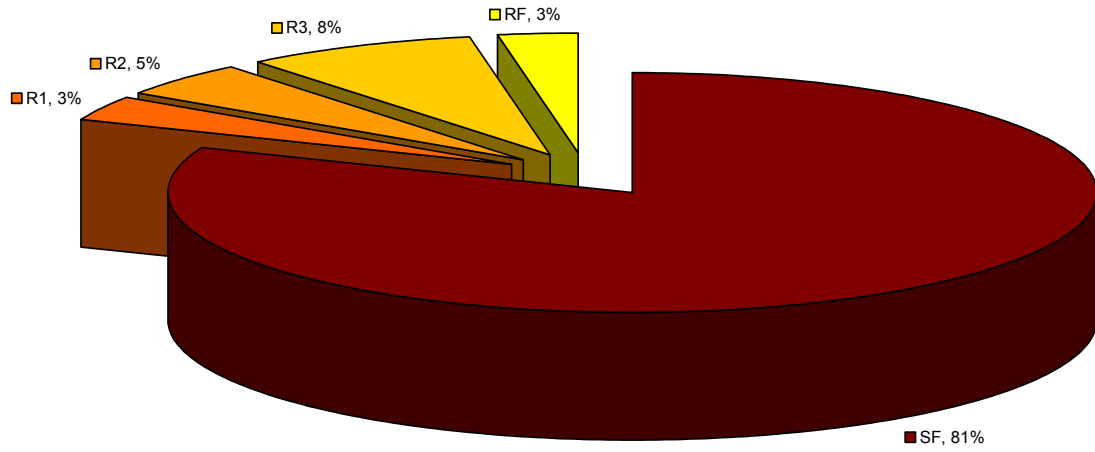


Chart 6:

Fraction of Negative Trading Charges Vs Run Type by Volume

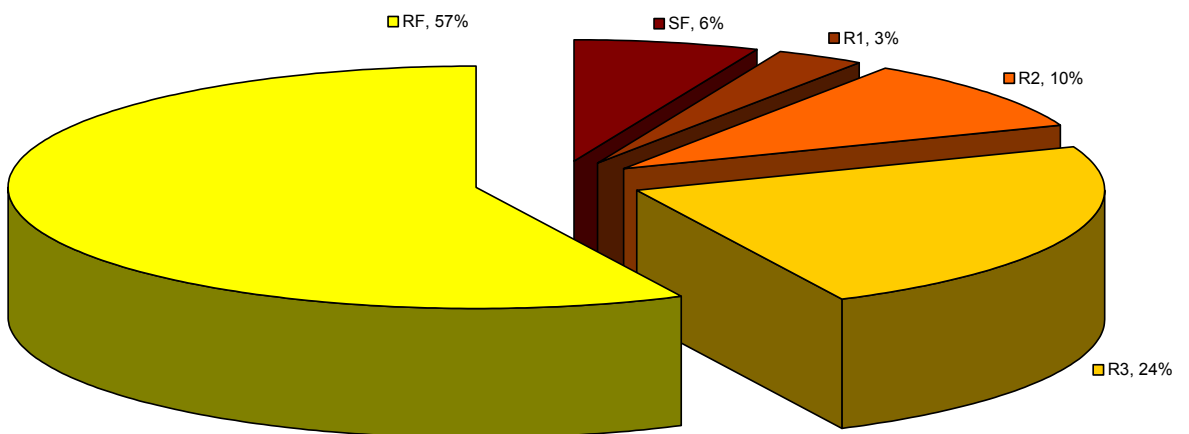


Chart 7:

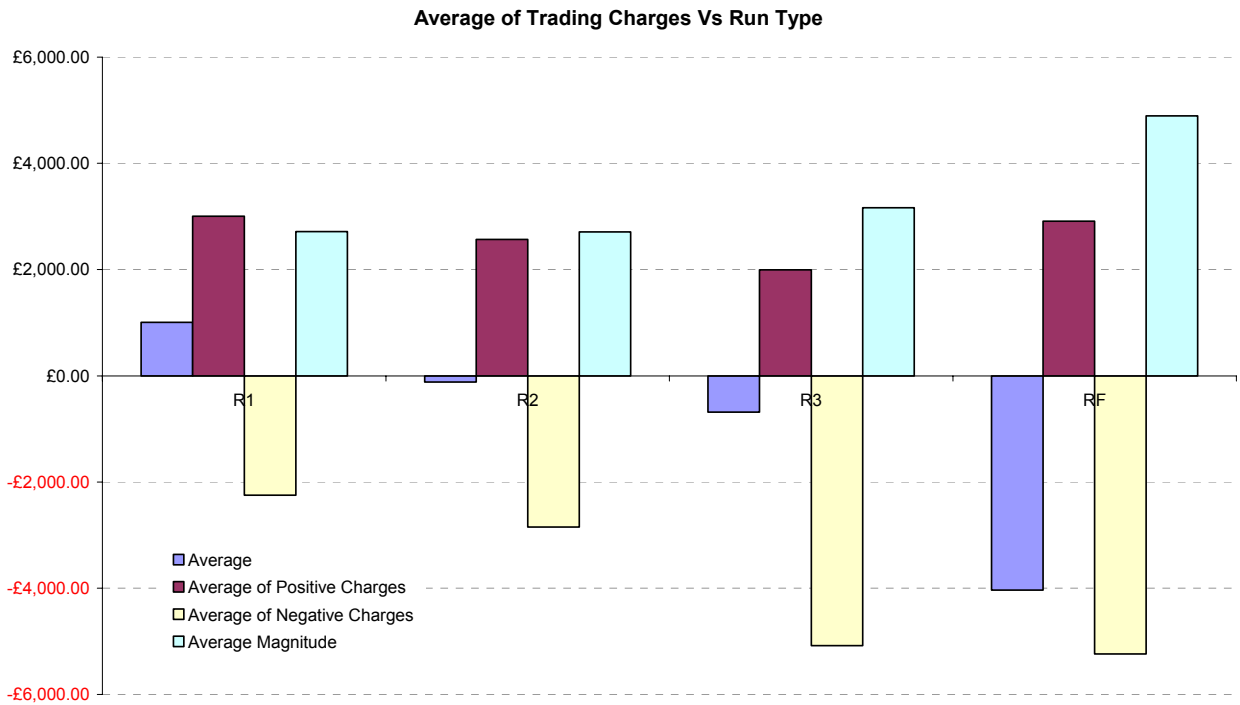
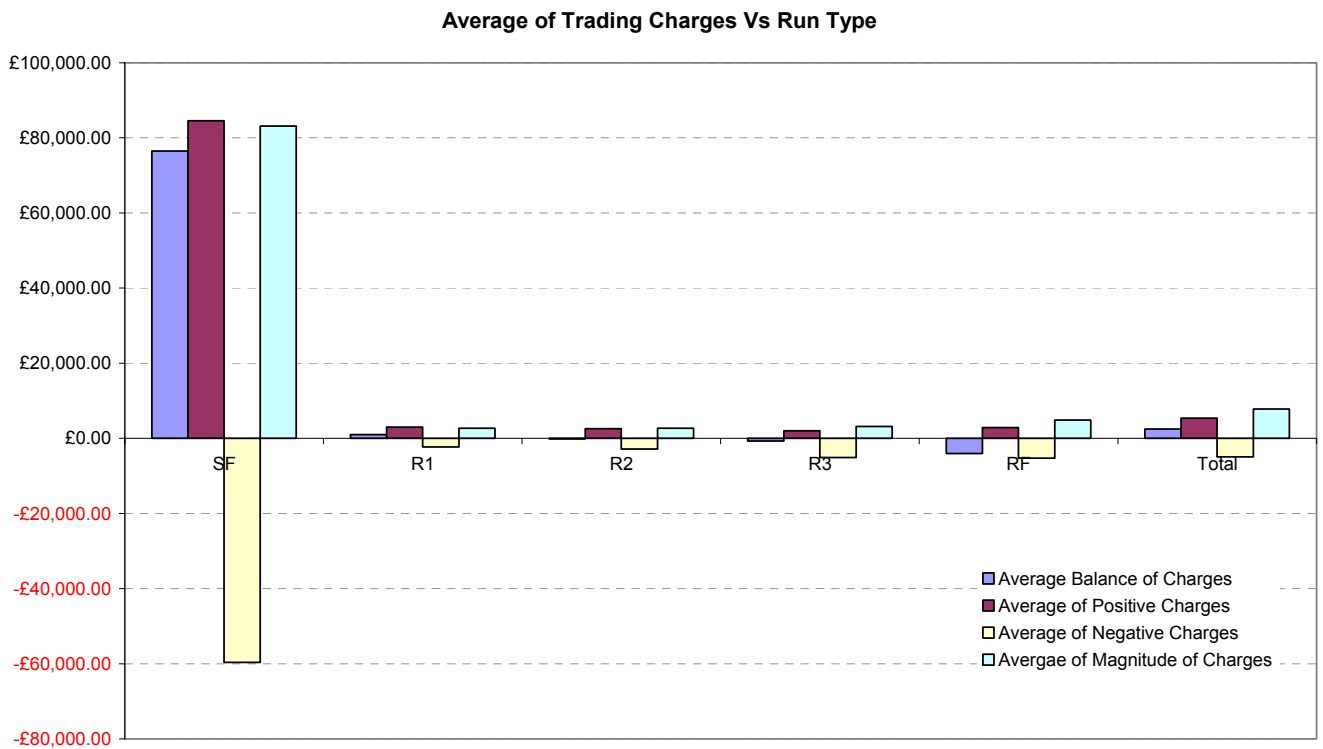


Chart 8:



Raw Data:

Totals:

	SF	R1	R2	R3	RF	Total
Maximum	£493,965	£31,164	£26,529	£8,656	£10,887	£493,965
Minimum	-£94,711	-£14,276	-£13,580	-£29,907	-£36,710	-£94,711
Total	£2,755,221	£63,273	-£15,329	-£155,763	-£956,431	£1,690,972
Total Positive	£2,874,481	£117,208	£164,219	£281,161	£101,898	£3,538,967
Total Negative	-£119,259	-£53,935	-£179,548	-£436,924	-£1,058,329	-£1,847,996
Magnitude Total	£2,993,740	£171,144	£343,767	£718,086	£1,160,226	£5,386,963
Number	36	63	127	227	237	690
Number Positive	34	39	64	141	35	313
Number Negative	2	24	63	86	202	377

Table 1: Individual Run data

Averages:

	SF	R1	R2	R3	RF	Total
Average	£76,533.93	£1,004.33	-£120.70	-£686.18	-£4,035.57	£2,450.68
Average Positive	£84,543.55	£3,005.34	£2,565.92	£1,994.05	£2,911.36	£5,402.47
Average Negative	-£59,629.71	-£2,247.30	-£2,849.97	-£5,080.51	-£5,239.25	-£4,901.84
Average Magnitude	£83,159.45	£2,716.57	£2,706.83	£3,163.37	£4,895.47	£7,807.19

Table 2: Averages

Percentages:

	SF	R1	R2	R3	RF
% of Run Type Positive-Volume	96%	68%	48%	39%	9%
% of Run Type Negative-Volume	4%	32%	52%	61%	91%
% of Total Positive- Volume	81%	3%	5%	8%	3%
% of Total Negative- Volume	6%	3%	10%	24%	57%
% of Total Magnitude-Volume	56%	3%	6%	13%	22%

Table 3: Positive/ Negative Splits