

# Overview of Credit Default

## Introduction

This document provides an overview of Credit Default. It does not cover the calculation of Energy Indebtedness and Credit Cover Percentage, but explains the steps followed when Credit Cover Percentages exceed various threshold values. Further information on this subject is contained in Sections M – ‘Credit Cover and Credit Default’, P – ‘Energy Contract Volumes and Metered Volume Reallocations’ and H – ‘General’, of the Balancing and Settlement Code (BSC). The BSC, a summary of the BSC and all subsidiary documentation, can be downloaded from [www.elexon.co.uk](http://www.elexon.co.uk).

## Credit Checking

At any given time, Trading Parties may have debts in respect of Trading Charges incurred but which have not yet been paid. The purpose of the credit checking arrangements is to ensure that, should a Trading Party default, sufficient collateral is available to pay these debts.

To this end, credit checking comprises two components:

- (i) the calculation of an estimate for each Trading Party of its accrued Trading Charges, known as the Energy Indebtedness; and
- (ii) in the event that Energy Indebtedness is at risk of exceeding the collateral provided (as represented by the Energy Credit Cover) taking steps to prevent Energy Indebtedness increasing further.

## Level 1 Credit Default

Steps are first taken if, in respect of any Settlement Period, Credit Cover Percentage<sup>1</sup> (CCP) becomes greater than 80%. The Trading Party is informed that its CCP has exceeded 80%, and a Query Period of 24 hours commences. During the Query Period the Trading Party may dispute the determination of its CCP, and the Energy Contract Volume Aggregation Agent (ECVAA) will undertake a review.

If, at the end of the Query Period, CCP for the given Settlement Period is still greater than 80%, the Trading Party must ensure that its CCP is reduced to less than 75% for at least one Settlement Period before the end of the next Business Day. The Trading Party may reduce its CCP by either posting additional collateral or by reducing its indebtedness by purchasing (and having notified to the ECVAA) contracts for additional energy. While additional collateral may only be posted during Funds Administration Agent (FAA) business hours, Energy Indebtedness can be reduced at anytime. However, reducing Energy Indebtedness will involve taking a ‘long position’ in one or more Settlement Periods, on which the Party will be exposed to the System Sell Price.

If the Trading Party fails to reduce its CCP, then the Trading Party will be in Level 1 Credit Default. The consequences of Level 1 Credit Default are that a notice is published on the Balancing Mechanism Reporting Agent (BMRA) website, and ELEXON issues an authorisation notice to the ECVAA that permits the rejection and refusal of contracts if the Trading Party’s CCP subsequently becomes greater than 90%.

The Trading Party will no longer be in Level 1 Credit Default when the CCP becomes less than 75%. The notice is removed from the BMRA website and the authorisation notice is withdrawn.

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<sup>1</sup> CCP is Energy Indebtedness divided by Energy Credit Cover.

## Level 2 Credit Default

Level 2 Credit Default procedures are initiated when a Party's CCP exceeds 90%. Provided that an authorisation notice (as described above) has been issued by ELEXON (and not withdrawn) the Trading Party will be in Level 2 Credit Default. The consequences of Level 2 Credit Default are that:

- (i) any Energy Contract Volume Notifications (ECVNs) or Meter Volume Reallocation Notifications (MVRNs) that are submitted and which would increase (or not decrease) Energy Indebtedness at any point in the future will be refused;
- (ii) any Energy Contract Volumes or Meter Volume Reallocations that have been previously notified and which increase Energy Indebtedness for the upcoming Settlement Period will be rejected, and the counter-parties to the notification are informed by the ECVA; and
- (iii) the fact is published on the BMRA website.

Energy Contract Volumes and Meter Volume Reallocations that increase Energy Indebtedness are those which represent the sale of energy by one Trading Party to another, and make the first Trading Party's Account Energy Imbalance Volume shorter. As future System Buy or System Sell Prices are unpredictable there is no way of knowing whether new ECVNs or MVRNs containing both sales and purchases will, overall, increase or decrease financial indebtedness. If an ECVN or MVRN represents the sale of energy in any Settlement Period, it is refused.

For previously notified ECVNs and MVRNs, the Energy Contract Volumes or Metered Volume Reallocations are rejected one Settlement Period at a time. However, rather than reject these for the Settlement Period for which Gate Closure has just elapsed, they are rejected for three Settlement Periods later. This gives the counter-party, who will otherwise be left short by the cancellation of a Volume Allocation in their favour, a limited time in which to re-contract with a different, non-defaulting Trading Party.

Level 2 Credit Default is cancelled at any time that CCP becomes less than 90%.

## Event of Default

A Trading Party may be in Level 1 or Level 2 Credit Default but continue to pay its Trading Charges when they are due. A Trading Party can be in Credit Default but not Payment Default. While not causing any bad debt to other BSC Parties, a Trading Party with a CCP of more than 100% is a risk to other BSC Parties as if it goes into Payment Default, it is unlikely there will be sufficient collateral to cover its debts. Consequently there would be a risk that the Trading Party's debts might not be recovered, and would have to be recovered, instead, from all other Trading Parties. The liability of other Trading Parties for a defaulting Trading Party's bad debts is based on its Funding Share, which is based mainly on the Trading Party's Credited Energy Volumes imported or exported, but also its volume of notified contracts, plus a number of other factors, such as BM Units and Metering Systems registered.

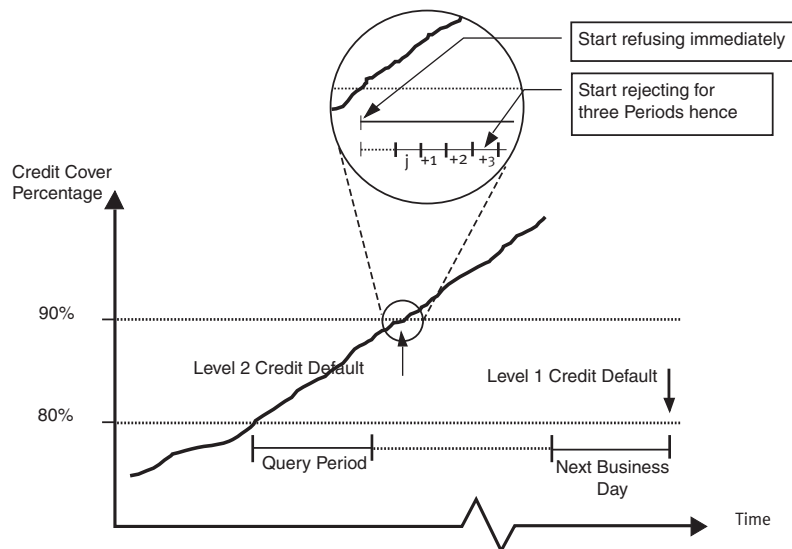
The BSC defines that a BSC Party in Credit Default can, in the following circumstances, become a Defaulting Party under the general provisions in Section H of the BSC if that Party:

- has been in Level 1 Credit Default for 90 continuous days or an intermittent period of 120 days out of 180;
- has been in Level 2 Credit Default for 60 continuous days or an intermittent period of 75 days out of 120;

- has been in Level 2 Credit Default with a Credit Cover Percentage greater than 100% for more than two working days; or
- has breached 100% Credit Cover Percentage six times within a rolling period of six months on separate days and as a result of separate instances.

In the event of Default, which may be triggered by a number of events, such as insolvency, the BSC Panel may take a number of steps including withdrawing the right to be party to any notifications, potentially de-energisation and expulsion from the BSC.

### Credit Default Levels



ELEXON is the Balancing and Settlement Code Company (BSCCo) defined and created by the Balancing and Settlement Code (BSC). All licenced electricity companies are obliged to sign the BSC, other parties may choose to do so. The BSC places obligations on ELEXON.

The rules and governance for trading in the balancing mechanism and imbalance settlement process are contained within the BSC, and it is these two areas that ELEXON manages in conjunction with the BSC Panel.

ELEXON procures, manages and operates services and systems, which enable the balancing and imbalance settlement of the wholesale electricity market and retail competition in electricity supply.

Wholesale electricity trading arrangements, introduced in England and Wales in 2001 and in Scotland in 2005, are designed to promote greater competition, while maintaining a secure and reliable electricity system. The arrangements allow electricity to be traded freely, based on established commodity trading practices.

The role of ELEXON and the BSC arrangements are more fully described on **[www.elexon.co.uk](http://www.elexon.co.uk)**.

If you have any feedback on this Information Sheet or any of ELEXON's publications, please email **[communications@elexon.co.uk](mailto:communications@elexon.co.uk)**, call on **020 7380 4119** or write to us at:

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