BSC Modification Proposal Form	At what stage is this document in the process?
# P385 ## Mod Title: Improving the efficacy and efficiency of the Section H Default provisions	01 Modification 02 Workgroup Report 03 Draft Modification Report 04 Final Modification Report

Purpose of Modification:

This Modification proposes amendments to the Default arrangements in BSC Section H 3 'Default' in order to increase visibility to industry of Parties at risk and to potentially allow for earlier remedial action by the BSC Panel

The Proposer recommends that this Modification should:

- **not** be a Self-Governance Modification Proposal; and
- be assessed by a Workgroup and submitted into the Assessment Procedure

This Modification will be presented by the Proposer to the BSC Panel on **11 April 2019**. The Panel will consider the Proposer's recommendation and determine how best to progress the Modification.

Low Impact:

BSC Parties

BSC Panel

ELEXON

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Contents

Any questions?

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Timetable

The Proposer recommends the following timetable:	
Initial Written Assessment presented to Panel	11 April 2019
Assessment Procedure Consultation	1 July – 19 July 2019
Workgroup Report presented to Panel	8 August 2019
Report Phase Consultation	12 Aug 2019 – 23 Aug 2019
Draft Modification Report presented to Panel	13 September 2019
Final Modification Report submitted to Authority	16 September 2019

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1 Summary

What is the issue?

The frequency of Balancing and Settlement Code (BSC) Parties failing to pay their debts and defaulting on the BSC has increased in 2018. After a period of 10 years without a Supplier of Last Resort event, there was a single occurrence in 2016 followed by an unprecedented 7 events in 2018 and 3 in 2019 at the time of writing.

This has resulted in greater exposure to unpaid Trading Charges which are then mutualised across other BSC Parties.

The BSC Panel has the ability to take mitigating action and provide financial protection when an Event of Default is triggered, but the current arrangements in BSC Section H 'General' are overly complex and prolong the period before an Event of Default is declared until it is often too late.

What is the proposed solution?

This Modification proposes to amend BSC Section H in such a manner as to introduce new Events of Default and simplify and reduce the periods after which an Event of Default is triggered.

The following changes should be considered by an industry Workgroup:

- Parties can remain in Level 1 Credit Default for 90 days or any intermittent period of 120 days out of 180 before triggering an Event of Default. Level 2 Credit Defaults can remain for 60 days or any period of 75 days out of 120. These periods before an Event of Default should be reduced with no intermittent periods.

- A Relevant Credit Default Series that will lead to an Event of Default occurs when a Party has breached 100% Credit Cover Percentage (CCP) 6 times in 6 months with a cooling off period in which further Credit Defaults are no longer counted. The number of occurrences should be reduced and simplified to count any Level 1 or 2 Credit Default towards a Relevant Credit Default Series, with no cooling off period.

- A new Event of Default should be introduced that triggers when a BSC Party uses Credit Cover to pay Trading Charges on 3 or more occasions within a 30 calendar day rolling period.

- A new Event of Default for Parties should be introduced that triggers when a Party publically announces that they are ceasing to trade.

2 Governance

Justification for proposed progression

This Modification should not be considered suitable for treatment as urgent, Fast Track or Self-Governance.

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This modification is expected to have a material effect on competition in the generation, distribution, or supply of electricity or any commercial activities connected with the generation, distribution, or supply of electricity and, as such, should not be treated as a Self-Governance Modification.

Requested Next Steps

This Modification should:

- assessed by a Workgroup; and
- submitted into the Assessment Procedure.

3 Why Change?

What is the issue?

The frequency of BSC Parties failing to pay their debts and, as a consequence defaulting on the BSC, has increased in 2018. This results in greater exposure to unpaid Trading Charges; which are then mutualised across other BSC Parties. After a period of 10 years without a Supplier of Last Resort event, there was a single occurrence in 2016 followed by 7 events in 2018 and by 3 in 2019 at the time of writing.

The current timescales for escalating a Party to the point where an Event of Default is triggered means that mitigating action by the Panel is delayed. It is important to take action promptly to minimise costs to industry through Default Funding Shares which ultimately passed on to the consumer.

Therefore, when a party in financial difficulty has been identified, the BSC Panel should have the opportunity to apply Consequences of Default, as available in BSC Section H 3.2, as early as possible. This will allow failing Parties be promptly identified to the BSC Panel and the wid.er Industry, potentially allowing the Panel to restrict the Parties activities and risks to counterparties.

Relevant Credit Default Series

Recurrent events of Credit Default are described as an Event of Default under a Relevant Credit Default Series under BSC Section H 3.1.1 (c) (iv). However the complexities of the current provisions for meeting the conditions for triggering this scenario make it difficult for Parties to understand what is expected from them.

Recent Credit Defaults have shown that the triggering of Level 2 Credit Default in cases where the Party has also exceeded 100% Credit Cover Percentage is a reliable indication that a Party is experiencing financial difficulty. However, the complexity of applying the rules to Parties who are already in the process of failing delays remedial action until the opportunity to apply the Consequences of Default and take protective action on behalf of BSC Parties has passed.

Non-payment of BSCCo Charges

Under current arrangements, there is a 15 day notice period following non-payment of BSCCo charges before an Event of Default is triggered. This 15 day period provides an unnecessarily generous window in which Parties can delay payment of BSCCo Charges before triggering an Event of Default.

Parties entering Administration

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There have been several recent instances of Parties publicly stating a notice to cease trading. However, as these Parties had not explicitly admitted that they would be unable to pay their debts to ELEXON and had not triggered Events of Default, the Panel have been limited in what actions can be taken, thus allowing the Party to potentially increase its debt to the detriment of other BSC Parties.

Where an Administrator is due to be appointed to a failing Party, the Party is subject to a 14 day notice Period prior to the formal appointment. The BSC does not recognise an Event of Default until the appointment of an Administrator.

By also simplifying the arrangements BSC Parties will be clearer about how, why and when an Event of Default is triggered and the consequences of doing so.

4 Code Specific Matters

Technical Skillsets

The Proposer recommends that the Workgroup assessing this Modification Proposal has expertise in the following areas:

- BSC Charges and payment;
- The Event of Defaults process;
- Credit Cover processes.

Reference Documents

BSC Section H - General

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5 Solution

Proposed Solution

This Modification proposes to amend BSC Section H in such a manner as to introduce new Events of Default and simplify and reduce the periods after which an Event of Default is triggered.

The proposed solution would promote visibility of a Party in financial difficulty to the BSC Panel at the earliest opportunity, thereby informing the wider industry and potentially protecting it from increasing amounts of bad debt.

These processes will also be simplified so Parties are clear on their credit obligations and the potential repercussions of becoming a Defaulting Party.

The aim of these proposed solutions is not to increase the numbers of Parties who trigger an Event of Default, but to allow remedial action to be taken earlier than under current arrangements to better protect non-Defaulting Parties and ultimately consumers. The Proposer believes that the proposed periods after which an Event of Default is triggered should act as prompt for Workgroup discussion.

New Events of Default

BSC Section H should be amended to introduce a new Event of Default that will trigger in the event that a BSC Party uses Credit Cover to pay Trading Charges on 3 or more occasions within a 30 calendar day rolling period.

BSC Section H should be amended to introduce a new Event of Default for Parties who have publically announced they are ceasing to trade. This would allow remediation and protect other Parties sooner.

Credit Default

Additionally, this Modification proposes that Credit Default provisions in BSC Section H 3.1.1 (c) (i) and (ii) should be amended to reduce the period after which Level 1 and 2 Credit Defaults trigger an Event of Default.

Under current provisions, Parties are allowed to remain in Level 1 Credit Default for 90 days or any intermittent period of 120 days out of 180 before triggering an Event of Default. Level 2 Credit Defaults are permitted to remain for 60 days or any intermittent period of 75 days out of 120.

The Proposer suggests that these should be reduced to 10 Working Days for Level 1 Credit Default and 5 Working Days for Level 2 Credit Default, with no intermittent periods.

Relevant Credit Default Series

A Relevant Credit Default Series currently occurs when a Party has breached 100% Credit Cover Percentage 6 times within a rolling period of 6 months on separate days with a cooling off period of 2 days in which Credit Defaults are no longer counted as a result of separate instances.

The Proposer suggests that BSC section H 3.1.1 (c) (iv) should be amended so that Relevant Credit Default Series occur upon any Level 1 or 2 Credit Default i.e. Level 1 or Level 2 with any Credit Cover Percentage.

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In the event that a Party clears the Credit Default there should be no cooling off period. The number of occurrences should be reduced to 3 occasions in a 6 month rolling period.

BSCCo charges

As described in BSC section H 3.1.1 (b) (iii) a Party is currently allowed to default on BSSCo Charges for a period of 15 Business Days before an Event of Default is triggered.

The Proposer suggests that this should be amended so that Parties who default on payment of BSCCo Charges trigger an Event of Default following 5 days of non-payment.

The Proposer notes that were the proposed solution already in effect, several Parties who ceased to trade in 2018 would have been identified to the Panel and wider industry in a more timely manner.

This would have additionally made them open to the Consequences of Default and allowed the Panel to potentially provide greater financial protection from mutualised bad debt for non-defaulting BSC Parties at an earlier opportunity.

6 Impacts & Other Considerations

Impacts

BSC Parties who enter credit or payment default will be impacted as a result of the implementation of this Modification. However, BSC Parties will be indirectly impacted as a result of the changes to Events of Default.

Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

The Proposer does not believe that this Modification is linked to any live Significant Code Reviews and requests that this Modification be exempt from the SCR process.

Consumer Impacts

By facilitating potential mitigating action to reduce the amount of bad debt that is paid by BSC Parties but ultimately falls on consumers, this Modification could have a positive impact on consumers.

Environmental Impacts

There will be no direct impact on the environment.

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7 Relevant Objectives

Impact of the Modification on the Relevant Objectives:	
Relevant Objective	Identified impact
a) The efficient discharge by the Transmission Company of the obligations imposed upon it by the Transmission Licence	Neutral
(b) The efficient, economic and co-ordinated operation of the National Electricity Transmission System	Neutral
(c) Promoting effective competition in the generation and supply of electricity and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity	**Positive**
(d) Promoting efficiency in the implementation of the balancing and settlement arrangements	**Positive**
(e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency [for the Co-operation of Energy Regulators]	Neutral
(f) Implementing and administrating the arrangements for the operation of contracts for difference and arrangements that facilitate the operation of a capacity market pursuant to EMR legislation	Neutral
(g) Compliance with the Transmission Losses Principle	Neutral

Views against Objective (c)

There are numerous reasons why a BSC Parties may go into default and ultimately fail. However when Parties gain a competitive advantage over their competitors by adopting riskier business models, those more conservative Parties shouldn't then be additionally penalised by picking up the cost of failure.

This Modification would not prevent failure from happening but may help to protect BSC Parties from an increasing debt burden that has the effect of stunting competition, especially for those Parties who cannot easily alter tariffs to cover the shortfall resulting from the mutualisation of bad debt.

Views against Objective (d)

This Modification would have a positive impact on the efficiency of the implementation of the Balancing and Settlement arrangements as it would reduce unnecessary delays in the defaults process and promote compliance with the BSC.

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8 Implementation Approach

As the proposed solution is expected to be a document-only change with no impact on BSC Systems, the Proposer believes that this Modification would be suitable for Implementation 5 Business Days following Authority approval.

9 Legal Text

BSC Section H

The Proposer believes that the necessary changes to BSC Section H 3 ‘Default’ to facilitate the solution would be straightforward and should be drafted as part of the Assessment Procedure.

10 Recommendations

Proposer’s Recommendation to the BSC Panel

The BSC Panel is invited to:

- Agree that this Modification Proposal not be progressed as a Self-Governance Modification Proposal; and
- Agree that this Modification Proposal be sent into the Assessment Procedure for assessment by a Workgroup.

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