



P385 'Improving the efficacy and efficiency of Section H Default provisions'

Workgroup Meeting 1

17 June 2019

Health & Safety

In case of an emergency

An alarm will sound to alert you. The alarm is tested for fifteen seconds every Wednesday at 9.20am

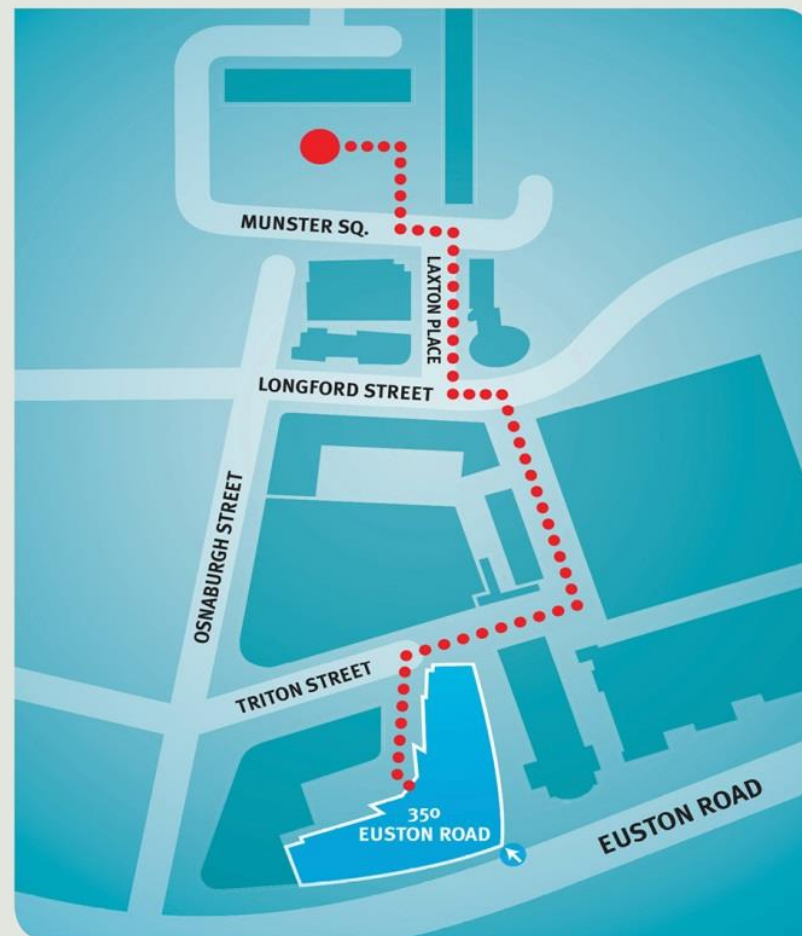
Evacuating 350 Euston Road

- If you discover a fire, operate one of the fire alarms next to the four emergency exits.
- Please do not tackle a fire yourself.
- If you hear the alarm, please leave the building immediately.
- Evacuate by the nearest signposted fire exit and walk to the assembly point.
- Please remain with a member of ELEXON staff and await further instructions from a Fire Warden.
- For visitors unable to use stairs, a Fire Warden will guide you to a refuge point and let the fire brigade know where you are.

When evacuating please remember

- Do not use the lifts.
- Do not re-enter the building until the all clear has been given by the Fire Warden or ground floor security.

Our team on reception is here to help you, if you have any questions, please do ask them.

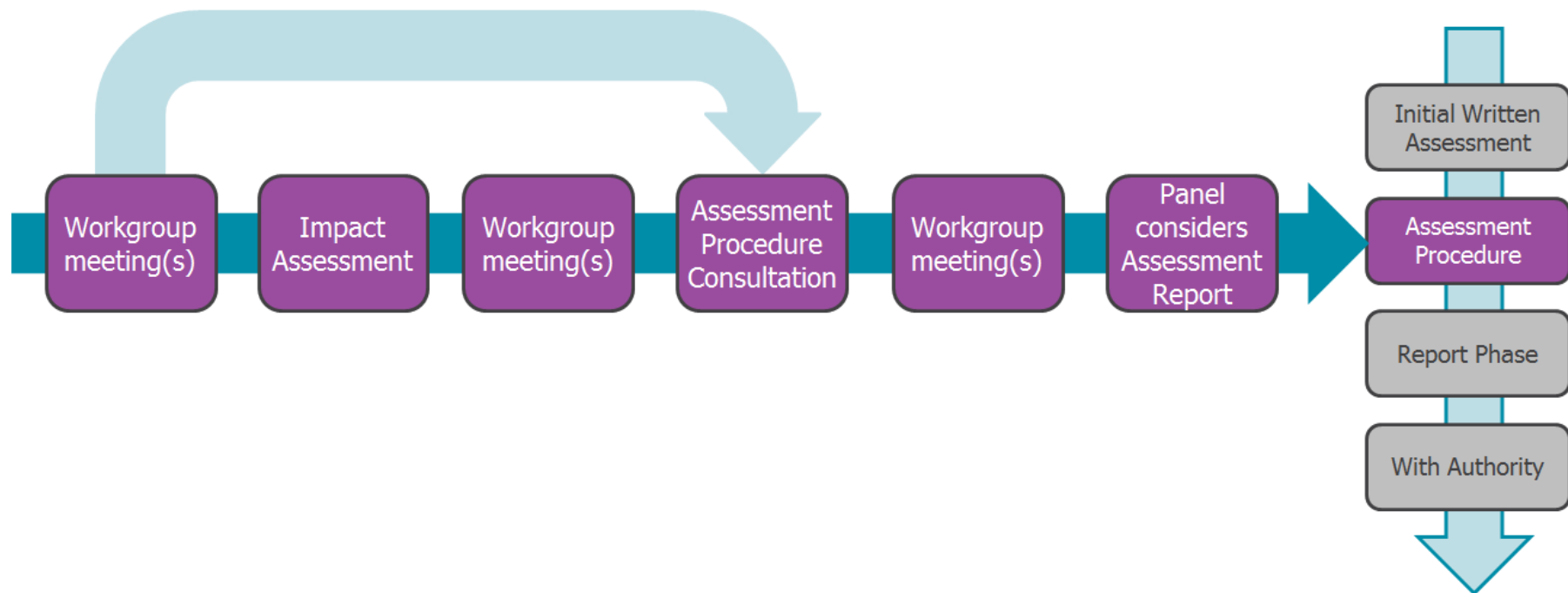


Meeting Agenda

Agenda item	Lead
1. Welcome and meeting objectives	Lawrence Jones (Chair)
2. Terms of reference and timetable	Ivar Macsween (Lead Analyst)
3. Overview of P385	Kevin Woollard (Proposer)
4. Background to P385	Ivar Macsween
5. Proposed New Events of Default	Nick Baker (Subject Matter Expert), Workgroup
6. Reducing the threshold for existing Events of Default	Nick Baker, Workgroup
7. Areas for consideration	Workgroup
8. Next steps	Ivar Macsween
9. Meeting close	Lawrence Jones

Meeting Objectives

- Consideration of P385 and Terms of Reference;
- Discuss the outcomes of the analysis; and
- Agree a solution that can be consulted on.





Terms of Reference

P385 Workgroup Terms of Reference *(1 of 2)*

- a) What is the impact on Parties from reducing the thresholds for triggering an Event of Default?
- b) What is the effect that increased visibility of Parties in financial difficulty will have on the wider market?
- c) Will the proposed solution have an effect on consumers?
- d) What is the associated risk of delivering the solution for P385 as part of a non-standard adhoc release?

P385 Workgroup Terms of Reference *(2 of 2)*

- e) How much time will Parties need to amend letters of credit and put up more Credit Cover?
- f) How do Credit Default provisions under the BSC compare with other industry Codes?
- g) What changes are needed to BSC documents, systems and processes to support P385 and what are the related costs and lead times?
- h) Are there any Alternative Modifications?
- i) Should P385 be progressed as a Self-Governance Modification?
- j) Does this Modification Proposal better facilitate the Applicable BSC Objectives than the current baseline?



Overview of P385

■ **Issue:**

- The BSC Panel has the ability to take mitigating action and provide financial protection when an Event of Default is triggered, but current BSC arrangements are overly complex and prolong declaring an Event of Default despite clear indications of financial difficulty.

■ **Proposed solution:**

- P385 proposes to introduce new Events of Default and simplify and reduce the periods after which an Event of Default is triggered.
- This would promote visibility of a Party in financial difficulty to the BSC Panel at the earliest opportunity, while potentially protecting BSC Parties from increasing amounts of bad debt.

Proposer's views against Applicable BSC Objectives *centrica*

■ **Objective (c):**

- When Parties gain a competitive advantage over their competitors by adopting riskier business models, those more conservative Parties shouldn't be additionally penalised by picking up the cost of failure.
- This Modification would help to protect BSC Parties from an increasing debt burden that has the effect of stunting competition.

■ **Objective (d):**

- This Modification would reduce unnecessary delays in the defaults process.
- This Modification would promote compliance with the BSC.

































Background to P385

P385: Background

- The frequency of BSC Parties defaulting on the BSC is increasing, resulting in greater exposure to unpaid Trading Charges which are then mutualised across other BSC Parties.
- After 10 years without a Supplier of Last Resort event, there was 1 occurrence in 2016 followed by an unprecedented 7 events in 2018 and 3 in 2019 so far.
- Events of Default, described under Section H, allow the BSC Panel to apply the Consequences of Default to a Defaulting Party.
- These “Panel Resolutions” give the Panel powers to take mitigating action and provide financial protection to the wider industry.
- Consequences of Default are not automatically triggered by an Event of Default but are options available to use at the Panel’s discretion.
- P385 is **not** proposing changes to the Credit Default thresholds in Section M.

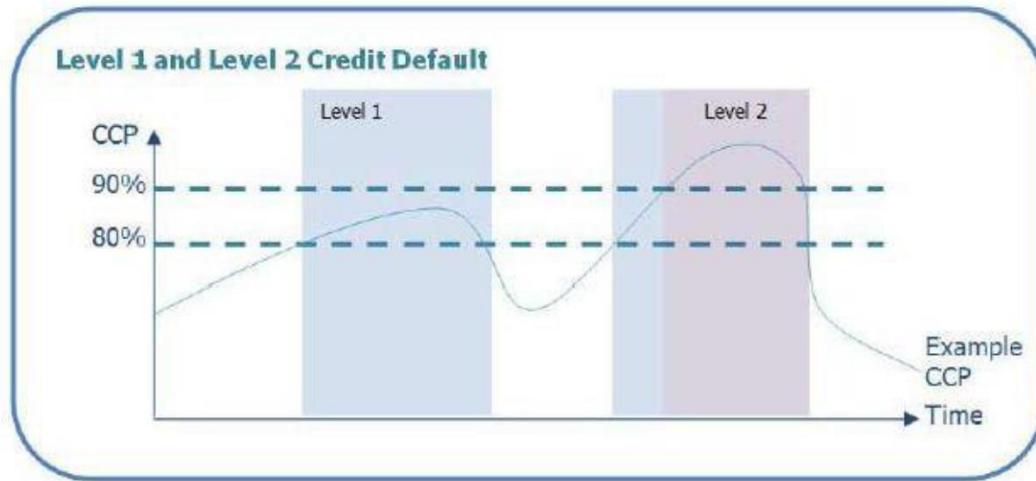
P385: Credit Cover (1 of 2)

M	T	W	T	F	S	S
	1 	2 	3 	4 	5 	6 
7 	8 	9 	10 	11 	12 	13 
14 	15 	16 	17 	18 	19 	20 
21 	22 	23 	24 	25 	26 	27 
28 	29 	30 	31			

- First invoice of a Settlement day is paid, on average, 29 calendar days after.
- ELEXON ask for sufficient collateral for Parties to trade in confidence that they will be paid for what they provide.
- When indebtedness goes above 80% of Credit Cover this triggers the Credit Default process.

$$\frac{\text{Total Energy Indebtedness (MWh)}}{\text{Credit Cover (MWh)}} \times 100 = \text{Credit Cover Percentage (CCP)}$$

P385: Credit Cover (2 of 2)



- Different timescales and consequences depending on levels:

$CCP \geq 80\% \Rightarrow$ Level 1 Credit Default

$CCP \geq 90\% \Rightarrow$ Level 2 90% Credit Default

$CCP \geq 100\% \Rightarrow$ Level 2 100% Credit Default

- The Query Period commences at the Submission Deadline for the Settlement Period for which the CCP became greater than 80%.
 - A minimum of 24 hours after the Trading Party has been informed
 - Must contain 5 consecutive Business Hours
 - This allows Parties to resolve with no consequences

P385: Events of Default

- BSC Section H 'General' paragraph 3.1 covers Events of Default.
 - Level 1 Credit Default can persist for a continuous period of 90 days or an intermittent period of 120 days out of 180 days.
 - Level 2 Credit Default can persist for a continuous period of 60 days or an intermittent period of 75 days out of 120 days.
 - Currently, a Party that is in Level 2 Credit Default with a Credit Cover Percentage that has exceeded 100% for 2 Working Days will trigger an Event of Default.
 - If a Party has not paid BSSCo charges for a period of 15 Business days after BSSCo notice an Event of Default is triggered.
 - Relevant Credit Default Series Level 2 Credit Default with a Credit Cover Percentage exceeding 100% on 5 occasions in 6 months.



**Any comments or
questions?**



Proposed New Events of Default

Proposed New 'Payment Default' Event of Default (1 of 2)

- New Event of Default (EoD) proposed for Parties using Credit Cover to pay Trading Charges on 3 or more occasions in a rolling 30 day calendar period.
- Historic Payment Default data has been analysed from 1 Jan 2017 - 31 Mar 2019.
- This retroactively resulted in 64 EoDs from **44 different Parties**.
 - **12 events** were for Parties that entered Section H Default for other reasons.
 - One BSC Party would have entered Section H Default **6 days earlier** under new EoD rules.
- Data included all Payment Defaults.
 - Excluding payments under the Advice Note Threshold of £500 (Underpayment, Quarterly Advice Notes) would have 57 Events from 37 Different Parties.

Proposed New 'Payment Default' Event of Default (2 of 2)

- Alternative scenarios were analysed and illustrated in Table 1.

Table 1. Alternative Occurrences and Time Frames

Number of payment defaults	Time frame within which payment defaults occur	Events	Different Parties
3	15	52	35
3	30	64	44
3	45	69	45
2	30	119	69
4	30	41	30

For Discussion...



Do the Workgroup believe that a new EoD triggered by use of Credit Cover to pay Trading Charges on 3 or more occasions in a rolling 30 day calendar period is appropriate? Would it be appropriate to exclude payments under the Advice Note Threshold?

Proposed New 'Ceasing to Trade' Event of Default (1 of 3)

- New Event of Default proposed for Parties who have publically announced they are ceasing to trade.
- The Consequences of Default allow the Funds Administration Agent (FAA) to withhold payments to a Defaulting Party. Potential for this to be applied earlier under a new EoD.
- Based on analysis of two SoLRs in 2019, this new EoD would have put both Parties in Section H Default one or two days earlier.
- Based on these examples a day of Trading Charges could be £10k.

Proposed New 'Ceasing to Trade' Event of Default (2 of 3)

- Theoretical scenario under current arrangements:
 - If Party has a long position (paid for surplus at SF), this money would continue to be paid until the FAA resolution is applied.
 - The Party stops trading. Negative indebtedness means Party will not enter Credit Default processes for a number of days.
 - Party would only enter Section H at this stage if it meets other Section H criteria (e.g administrator or admitting to pay debts).
 - If not, could be number of days continuing to be paid out, which could have been withheld for 100% exposure days.
- Theoretical scenario under proposed future arrangements:
 - The Party stops trading and triggers the new Event of Default, becoming open to the Consequences of Default.

Proposed New 'Ceasing to Trade' Event of Default (3 of 3)

- Legal Text considerations:
 - What language is appropriate and 'futureproof'?

For Discussion...



Do the Workgroup believe that a new EoD triggered by Parties who have publically announced they are ceasing to trade would be appropriate?



Proposed Reductions to Thresholds for Triggering Events of Default

Reduction to 'Credit Default' Events of Default (1 of 2)

- Proposed amendments to Credit Default provisions in BSC Section H 3.1.1 (c) (i) and (ii) 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.
- Proposed reduction to 10 Working Days for Level 1 Credit Default and 5 Working Days for Level 2 Credit Default, with no intermittent periods.
- Historical Credit Default data analysed from 1 Jan 2017 – 31 Mar 2019.
 - There were 535 Credit Default events in this time period.
 - 44 total instances of BSC Parties having at least an authorised Level 1 or Level 2 Default.

Reduction to 'Credit Default' Events of Default (2 of 2)

Credit Default	Authorised Instances	Instances above new Section H thresholds (10/5 Working Days)
Level 1	22	13
Level 2	39	13

- Level 1- **One new Section H Default** would have occurred under proposed solution for a Party who were in authorised Level 1 Default for 10 Working Days.
- Level 2- **No new Section H Defaults** under proposed solution.
 - Parties in Level 2 (CCP >90%), tend to also exceed 100% and therefore trigger Section H 3.1.1(c)(iii).
 - Parties capable of staying within a 10% Credit Cover Percentage range for multiple days as actioned by Party who was in Level 1 Default.

For Discussion...



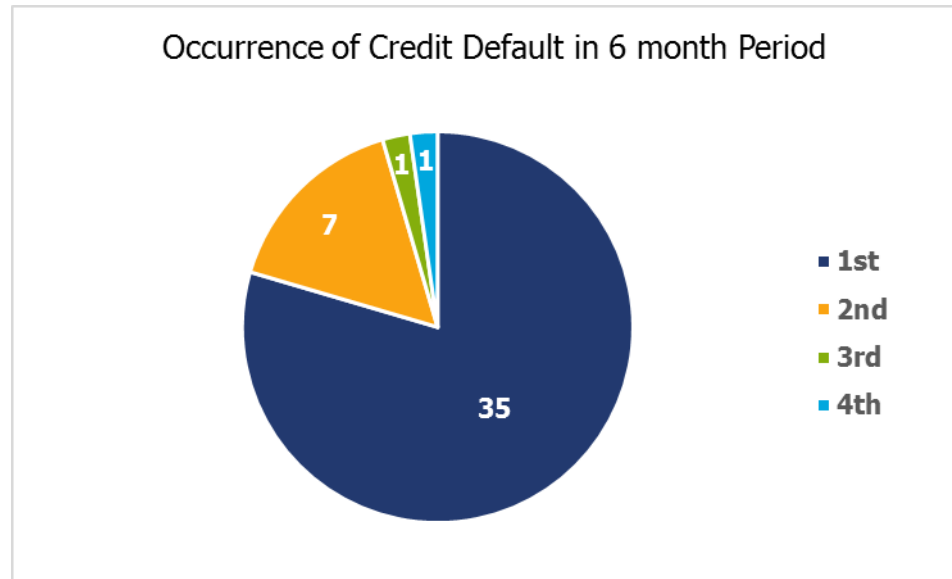
Do the Workgroup believe that reductions to 10 and 5 Working Days are appropriate?

Reduction to 'Relevant Credit Default Series' (1 of 2)

- 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 separate instances.
- Proposed amendment 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)
- 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 months rolling period.

Reduction to 'Relevant Credit Default Series' (2 of 2)

- Historical Credit Default data analysed from 1 Jan 2017 – 31 Mar 2019.
 - 44 total instances of BSC Parties having at least an authorised Level 1 or Level 2 Default



- One Party would have triggered Section H under proposed solution. The Party was not currently in Section H Default at the time, but entered two weeks later.

For Discussion...



Do the Workgroup believe that the proposed reduction is appropriate?

Reduction to 'BSCCo Charges' Event of Default (1 of 3)

- A Party is currently allowed to default on BSCCo charges for a period of 15 Business days before an Event of Default is triggered.
- Proposed to amend so that Parties who default on payment of BSCCo charges trigger an Event of Default following 5 days of non-payment.

Reduction to 'BSCCo Charges' Event of Default (2 of 3)

- BSCCo Charge payment data analysed for BSC Year 2018/19.
- 385 BSCCo Charges invoices were paid late in 2018/19 (9.1%).
- Under current Section H rules, 34 Parties have been in Section H Default under 3.1.1(b)(iii)- 15 Working Days before an EoD is triggered.
- Based on a proposed change to 5 Working Days, this would increase to 139 EoDs.
- ELEXON believe that if new rules were in place, Parties would change to behave differently.

	Number of Working Days Late			
Month	0-5	6-10	10-15	16+
Apr-18	8	4		
May-18	29	6	3	1
Jun-18	13	1	4	2
Jul-18	37	6	4	3
Aug-18	27	9	2	7
Sep-18	23	9	6	5
Oct-18	17	4	2	1
Nov-18	21	9	5	5
Dec-18	17	2	1	4
Jan-19	16	6	2	4
Feb-19	16	9	5	2
Mar-19	22	5	1	
Yearly Total	246	70	35	34

Reduction to 'BSCCo Charges' Event of Default (3 of 3)

- ELEXON would like payment performance to be improved, but need to be significant for value/effort of BSC Panel.
- An alternative option may be progressed:
 - similar to the new Payment Default EoD
 - have a number of failures within certain time frame.
 - Consecutive/non-consecutive?
- What timescale is reasonable for the payment process?

For Discussion...



Do the Workgroup believe the reduction is appropriate or is an alternative approach more suitable?



**Further areas for
consideration**

P385 Workgroup Terms of Reference

- a) The impact on Parties of reducing the thresholds for triggering an Event of Default.
- b) The effect that increased visibility of Parties in financial difficulty will have on the wider market.
- c) Will the proposed solution have an effect on consumers?
- d) The associated risk of delivering the solution for P385 as part of a non-standard adhoc release.
- e) The amount of time that Parties need to amend letters of credit and put up more Credit Cover.
- f) How Credit Default provisions under the BSC compare with other industry Codes?

Standard Terms of Reference

- g) What changes are needed to BSC documents, systems and processes to support P385 and what are the related costs and lead times?
- h) Are there any Alternative Modifications?
- i) Should P385 be progressed as a Self-Governance Modification?
- j) Does P385 better facilitate the Applicable BSC Objectives than the current baseline?



Next steps

P385 Next Steps

- Further analysis as appropriate
- Draft solution will be developed, and Workgroup views sought at the next meeting
- W/C 8 July: WG review Business Requirements
- W/C 8 July: WG review Legal Text
- W/C 15 July: Discuss any unresolved issues with solution at next meeting
- W/C 15 July: Gather Workgroup views on Objectives etc. at next meeting
- Next meeting could be via teleconference

P385 Proposed Timetable

Event	Date
Present IWA to Panel	11 April 19
Workgroup meeting 1	17 June 19
Workgroup meeting 2	W/C 15 July 19
Assessment Procedure Consultation	29 July – 16 Aug 2019
Workgroup meeting 3	W/C 19 Aug
Present Assessment Report to Panel	12 Sep 2019
Report Phase Consultation	13 Sep – 2 Oct 2019
Present Draft Modification Report to Panel	10 Oct 2019
Issue Final Modification Report to Authority	14 Oct 2019

