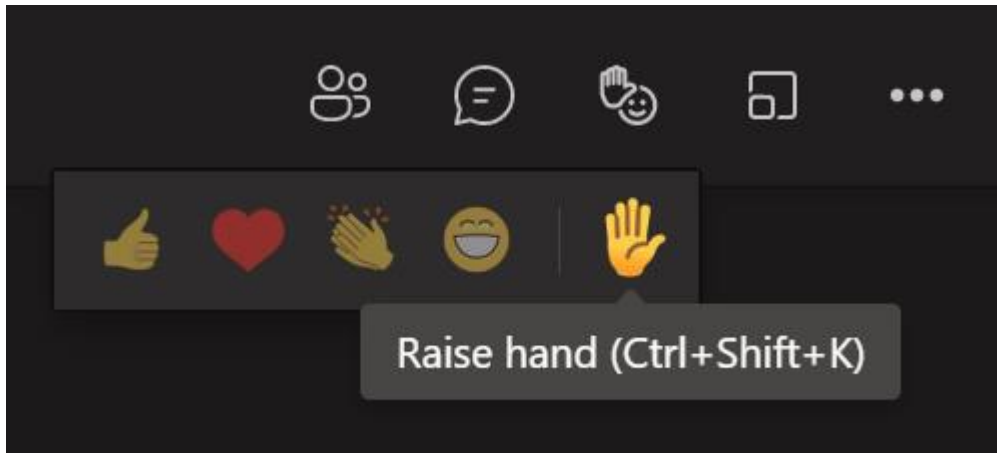


P426 Digital Meeting Etiquette

- Welcome to **P426 ‘Combining related BSC Parties’ Energy Indebtedness positions for the Credit Cover Percentage calculation’** Workgroup Meeting 2 – we’ll start shortly
- No video please to conserve bandwidth
- Please stay on mute unless you need to talk – use the **Raise hand** feature in the menu bar in Microsoft Teams if you want to speak, or use the **Meeting chat**



- Lots of us are working remotely – be mindful of background noise and connection speeds

ELEXION

P426 Workgroup 2

Combining related BSC Parties' Energy
Indebtedness positions for the Credit Cover
Percentage calculation

7 September 2022

Meeting Agenda & Objectives

- Consideration of legal feedback on proposed solution
- Further development and refinement of proposed solution

Agenda Item	Lead
1. Welcome and Meeting objectives	Keren Kelly (Chair)
2. Summary of WG1 and Actions	Paul Wheeler (Lead Analyst)
3. Overview of Payment and Credit Default process	Tirath Maan (SME)
4. Development of proposed solution <ul style="list-style-type: none">• Provision of Credit Cover• Defining entities• Governance and process	Chris Wood (Design Authority)
5. Discussion on the proposed solution	Workgroup
6. Next steps	Paul Wheeler
7. AOB & Meeting close	Keren Kelly



SUMMARY OF WG1 AND ACTIONS

P426 WG1 Summary

- The Workgroup considered the issue and the proposed solution shared by the Proposer under P426.
 - Energy Indebtedness is calculated for each BSC Party and Credit Cover must be lodged on that basis. There is no option for Suppliers within the same group to provide collective credit arrangements, which can result in disproportionate and inefficient levels of credit being lodged.
 - The proposed solution is to provide the option for related BSC Parties to utilise shared credit arrangements.
 - The Workgroup questioned and discussed the proposal including:
 - how parties would be considered 'related' and the types of organisations that might make use of the proposed solution;
 - whether proposed arrangements would be acceptable to industry and banks; and
 - the need for a clear cost/benefit analysis.
- The Workgroup noted the Terms of Reference.
- Elexon provided an overview of the BSC Credit Cover arrangements.
- The Proposer outlined the benefits of the proposed solution and the Workgroup further discussed considerations for the proposed solution.
 - The Workgroup discussed:
 - if the proposed solution was legally enforceable and Elexon agreed to seek legal advice;
 - if the solution was intended to apply to all credit instruments;
 - whether a party providing credit would need to be a BSC Party; and
 - whether the existing MVRN process could be used to facilitate a similar outcome to the proposed solution.
- Elexon presented thoughts on wider market context and potential BSC impacts
 - The Workgroup discussed procedural elements of the proposed solution, including when and how the credit relationship arrangement could be changed, when data should be combined as part of credit cover calculations and transparency to the market in default situations.

P426 WG1 Actions

1. Elexon to provide an overview of the Credit Default and Payment Default processes at the next Workgroup meeting
2. Elexon to engage with its legal team to consider questions raised and to feed back at the next Workgroup meeting
3. Elexon to further develop the P426 solution based on feedback and discussion by the Workgroup, for consideration at the next Workgroup meeting



OVERVIEW OF PAYMENT AND CREDIT DEFAULT PROCESS

The Credit Default Process

- When a Party's Total Energy Indebtedness (TEI) goes above 80% of their Credit Cover collateral this triggers the Credit Default process. Credit Cover Percentage (CCP) > 80%.
- The initial 80% threshold breach is a Credit breach. A 24 hour consequence free Query Period will always apply. It must include at least 5 consecutive business hours. A Cure Period will then apply if CCP is still greater than 80% but less than 90%.
- Different timescales and consequences depending on levels:
 - CCP ≥ 80% => Level 1 Credit Default
 - CCP ≥ 90% => Level 2 90% Credit Default
 - CCP ≥ 100% => Level 2 100% Credit Default
- When a Party is in Level 1 or 2 Credit Default, its details are published via a notice on the BMRA website and ECVNs/MVRNs can be rejected by the ECVA.

How Does This Link to Payment Default?

- Once the Trading Charges due for any given Settlement Day pass out of the Credit Cover calculation, those charges are then invoiced. If sums owed for Trading Charges are not paid by BSC Parties on the due date it is listed as a Payment Default. The Funds Administration Agent (FAA) monitors for Payment Defaults each day.
- BSC Parties must follow the Credit & Payment obligations as set out under Section M & N of the BSC. Credit Cover should not be actively used as a facility to pay Trading Charge invoices.
- P385 Modification implemented to flag poor payment performance and mitigate risk of bad debt.
- 3 counts of non-payment within a 30 calendar day rolling period, results in Event of Default under Section H 3.1.1(a)(A)(iii).
- A Party may be in Level 1 or Level 2 Credit Default but continue to pay Trading Charges when they are due. Credit Default is a risk to other Parties, as if a party does stop paying invoices it may not have enough credit collateral to cover debts. Where debts are not recovered, this is mutualised to the industry via Default Funding Share (DFS).

Payment Default Timings

- **Payment Due Date**

Payment must be made in full by COB (5pm) on due date.

- **Due Date + 1**

Reduction in Credit Cover for amount due reflected in internal systems (ECVAA/Elexon Portal/FAA). If payment made, reconciled back to Credit Cover next WD.

- **Due Date + 2**

Actual claim made on Credit Cover including any interest due.

If full amount not paid by 09:00 on D+2, listed as count of non-payment.

- **Due Date + 3**

If amount not settled in full by COB (5pm), Event of Default under Section H3.1.1(a)(iii).

Triggers of Section H Default

- Section H of the BSC sets out the rules relating to default under the BSC and details of how a BSC Party can become a Defaulting Party. Although general defaulting provisions are much wider than just Credit/Payment Default, there are a number of triggers which cover instances of prolonged Credit Default and non-payment of Trading Charges. BSC Section H3.1.1 details the reasons for Section H Default.
- A Party in Credit Default can, in the following circumstances, become a Defaulting Party under Section H if:
 - => Has three Authorised Credit Defaults (i.e. published to BMRS) in a period of six months;
 - => Has been in Level 2 Credit Default with a Credit Cover Percentage greater than 100% for more than two working days;
 - => Has been in Level 2 Credit Default for 60 continuous days or an intermittent period of 75 days out of 120; or
 - => Has been in Level 1 Credit Default for 90 continuous days or an intermittent period of 120 days out of 180.
- A Party in Payment Default can become a Defaulting Party under Section H if:
 - => It has not paid Trading Charges owed in full by the 3rd business day of the due date;
 - => It has 3 or more instances of non payment at 09:00 on D+2 of the payment due date, this includes the scenario where Credit Cover is used to clear the Advice Note;



DEVELOPMENT OF PROPOSED SOLUTION

Solution overview

- The Proposal is to provide the option that BSC Parties are able to rely on shared credit arrangements and provision
 - The Energy Indebtedness of each BSC Party should be combined
 - The Credit Cover Calculation shall be performed on the combined position
 - The solution can apply to companies within the same Group or companies entering into a commercial arrangement
- The solution can be split into three distinct areas:
 - Defining the entities;
 - Provision of Credit Cover; and
 - Governance and Processes.



DEFINING THE ENTITIES

Company definition and relationships

- We need to be able to determine individual legal entities
 - Each company has to be considered a separate entity in its own right
 - Market Entry process – Company house checks etc. – allows us to check whether a company exists
 - Could be determined by investigating ownership, accounts, whether Company Officers are the same etc. but, this is resource intensive
 - We have authority over BSC Parties, so only BSC Parties should be allowed to enter into sharing arrangements, their legal relationship with each other is outside of the BSC's scope
 - Would not apply to White Labelling or similar i.e. just two companies entering into an arrangement outside of the BSC i.e. all entities have to be BSC Parties
- Given that new companies can join the BSC at any time, so should sharing of credit be allowed at any time
 - So long as each individual company/Party can be established as such, their relationship shouldn't really matter – though note some may not have the right to provide credit
 - So long as we have enough Credit lodged should either fail, we don't really need to concern ourselves beyond that
 - The timing of entering into an arrangement should not matter either
 - However, we need to be considerate of resource impact for joining and leaving partnership
 - Could be at 29 day point based on time to go through full Energy Indebtedness (EI) process?
 - Need to avoid using this to mask bad debt – rule that can't share liability if either has defaulted in last 58 days?
- As per other Settlement liability, won't be released from credit arrangement until RF i.e. 14 months

Liability of when electing to share becomes 'Settlement Data'

- Settlement: means the determination and settlement of amounts payable in respect of Trading Charges (including Reconciliation Charges) in accordance with the Code (including where the context admits Volume Allocation)
 - Section U 1.6 defines “settlement data” in the case of a Party as:
‘Relates to that Party and is received, produced or sent by that Party or its Party Agent’
- BSC Data has the meaning given in H11.2.1:
‘Data or information held by, or on behalf of, BSCCo (including BSC Agents) and which is received, produced or sent by or on behalf of Parties under the Code (including, for the avoidance of doubt, by BSC Agents and Party Agents) for the purposes of Settlement but excluding any data or information that the Code explicitly identifies as confidential’
- Settlement risk is defined in Section Z5.1.1(a):
‘A risk of any failure or error in a step or process required under the Code (including in each case a risk which has materialised as an actual failure or an error) for the purpose of effecting Settlement or otherwise required in connection with Settlement in accordance with the provisions of the Code’
- Based on the above – the fact that credit will be shared makes it information held by BSCCo sent by a BSC Party under the Code so can be classed as BSC Data. Given that the information relates to a Party and is sent by a Party, it is Settlement Data

Legal risks

- A guarantee is a secondary liability contingent on the underlying agreement
- An indemnity is a primary liability independent of the underlying agreement and generally survives termination of the underlying agreement
- Irrevocable Letters of Credit and Insurance and cash, as provided for presently are the safest methods of security
- Guarantees and indemnities are not so safe and allow more successful challenge
- Downstream group company security is workable, if less safe and requiring more work. Upstream or cross-stream is less safe
- Security offered by a non-group company is least safe and affords more opportunity for attack from shareholders, insolvency practitioners and even by the company itself arguing against any security it has given



PROVISION OF CREDIT COVER

Provision of Credit Cover

- When calculations occur, and why?
 - We can either do this at the start of the process or at the end
 - Our recommendation is that it should be at the end
 - Adding each other's meter reads, and multiplying by various factors (e.g. Transmission Losses will be different) will just make things complicated,
 - Unless we consider the joint venture the same as a lead Party, in which case, we can use the precedence we already have
 - However, if each Party has multiple energy accounts, then this again gets very complicated

When calculations occur

Total Energy Indebtedness = Credit Assessment Energy Indebtedness + Metered Energy Indebtedness + Actual Energy Indebtedness (CEI+MEI+AEI=TEI)

- CEI is a proxy for metered volumes for 2/5 WD (Qualifying/non Qualifying BM Units). For Qualifying BM Units is FPNs minus Contracts and Includes:
 - CALF (GC or DC) and MVRN Data
 - For credit qualifying BM Units FPN data
 - Uses Energy Contract Volumes for Production and Consumption
- MEI is only used for Credit Qualifying BM Units for 3-5 WD
 - For Qualifying BM Units is Metered Volumes (from CDCA) minus Contracts
- AEI is from 5WD until 29 Calendar days
 - AEI = Trading Charges divided by Credit Assessment Price (CAP)

When calculations occur

Credit Cover Percentage = TEI divided by Credit Cover times One Hundred

- Credit Cover Percentage (CCPpj) formula is:

$$CCPpj = \left(\frac{Elpj}{ECCp} \right) \times 100$$

- Elpj is Energy Indebtedness (TEI as shown previously)
- ECCp is Energy Credit Cover, which is $CCp \div CAP$
- CCp is the amount of the Imbalance Party's Credit Cover at that time
- The CAP is determined by the Panel and is based on the two-month ahead selling price and can be reviewed as required depending on whether a trigger is reached

$$CCPpj = \left(Elpj \div \left(\frac{CCp}{CAP} \right) \right) \times 100$$

- Party's Credit Cover can be determined by:

$$CCp = \frac{100 \times Elpj \times CAP}{CCPpj}$$

- If the minimum cover provided is 80% (to avoid triggering BSC Actions), then the formula would look like:

$$Credit\ Cover\ (£) = \frac{100 \times (Party\ A's\ TEI + Party\ B's\ TEI) \times CAP}{80}$$

Problems to solve

- What happens if only one fails and associated default process(es)?
 - If one party in the partnership enters liquidation or similar, then the partnership will end immediately as notice is given
 - The partnership may be terminated sooner by the BSC Panel if the Panel is made aware of potential failure based on market intelligence
 - If we calculate each Party's Energy Indebtedness, then it will be relatively easy to calculate the other Parties' minimum Credit Cover in the event of the relationship ending and we just carry on as though nothing had happened
 - Including putting the second party into default if applicable – as such, recommend a 1WD adjustment period
- When will credit default process commence, and which will be affected
 - Credit default processes will apply to all entities in the partnership
 - Will commence as per Section M
 - Joint benefit, joint pain i.e. if one causes a default, then both are classed as being in default
- Action if parent company severs relations with a subsidiary
 - The subsidiary will revert to the same existing arrangements for any other Party that is not sharing credit cover
 - If there are multiple subsidiaries, then the same will apply
 - Similarly, we will apply the standard process to the 'parent'

Problems to solve

- Will banks or Insurers provide credit cover
 - It is the responsibility of those concerned to ensure cover is in place, if they can't arrange cover, then single entity arrangements prevail
 - The responsibility will sit with the respective parties to arrange
 - So long as the provisions in M2.2
 - Similarly, if the bank/insurer won't provide cover for all Parties, single Party rules apply
- Legal enforcement of shared liability
 - The provisions of M2.2 will apply as they do now, so we will 'collect' in the same way as though we were dealing with a single party
 - Parties need to make this clear to their coverer when carrying out M2.2 actions and the cover should make specific reference to this
- How much should be lodged
 - See previous slides for a combined entity
 - The cover note should explicitly include whether new cover notes will automatically be issued in the event of a split, or will all cover cease to exist
 - The 1WD grace period will allow time to for new arrangements to 'kick-in'



GOVERNANCE AND PROCESS

Governance and process

- Ensuring all parties consent to sharing credit
 - The notification shouldn't become effective unless both parties agree
 - Participant Management Product (PMP) platform will need updating and rules to allow for this – Cat A will be starting point
 - A BSCP form (automated) can be used and checked by BSCCo – would require director signature
 - Both parties will need to notify the change separately
- Changes of notification in status etc. – ensuring we're notified
 - Like with change in status, we can make it a requirement in the BSC and various CSDs
 - We can use the OSMs to check in regularly
- How will sharing be notified and checked
 - Build a rule into BSC Systems to notify BSCCo that a notice to share liability has been submitted
 - Will need a KPI for BSCCo to process the checks – 5WD?

Governance and process

- Prevention of undue processes and limiting resource liability – needs to be no more or less than existing processes
 - Other measures proposed should hopefully take care of this
- What, and when we should publish data – Transparency regulation and REMIT
 - Initial thought is that we should follow existing precedence i.e. we only publish when a default occurs
- Companies telling each other information and/or BSCCo disclosing information
 - Not much we can do about this – under existing arrangements, if they want to share information they can
 - Ofgem has the obligation to spot insider information, not BSCCo
 - If required, we can build something into PMP to notify Ofgem companies are sharing liability so they can look out for insider information
- MVRN is simpler/preferred – can we learn anything from this
 - Sharing credit cover is optional, companies may prefer to MVRN
- Preventing gaming
 - Measures around 29 and 58 days will prevent gaming, but not much we can do without huge resource implications



NEXT STEPS

Next steps

- WG2 Summary to be issued by 14 September
- Elexon to progress Impact Assessment(s)
 - Costs and timescales for System changes
 - BSC Sections requiring change and timescales
 - Code Subsidiary Documents requiring change and timescales
 - Deconfliction with other planned changes
 - Draft cost-benefit-analysis
- Confirm possible dates for WG3
 - Review Impact assessments
 - Review cost-benefit analysis
 - Agree scope of consultation
 - Gather Workgroup's views
- Plan to issue the Assessment Procedure Consultation following WG3

MEETING CLOSE

ELEXON

THANK YOU

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7 September 2022