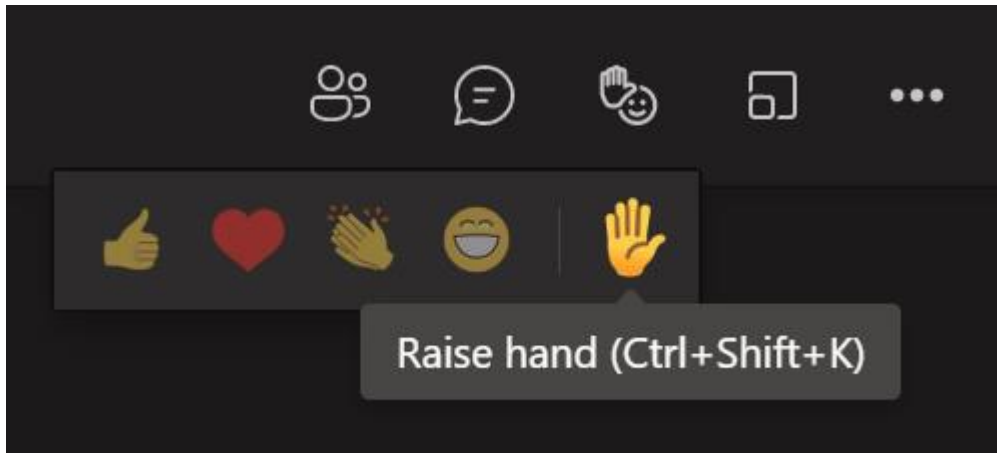


P426 Digital Meeting Etiquette

- Welcome to **P426 ‘Combining related BSC Parties’ Energy Indebtedness positions for the Credit Cover Percentage calculation’** Workgroup Meeting 3 – 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 3

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

20 October 2022

Meeting Agenda & Objectives

- Consideration of risk mitigations for proposed solution
- Further development and refinement of proposed solution

Agenda Item	Lead
1. Welcome and Meeting objectives	Keren Kelly (Chair)
2. Summary of Workgroup 2 and Actions	Paul Wheeler (Lead Analyst)
3. Risk mitigations <ul style="list-style-type: none">• Eligibility to qualify for combined indebtedness• Applying for combined Credit Cover• BSC Rules changes• Ongoing monitoring following approval• Actions in the event of Default	Chris Wood (Design Authority)
4. Discussion on the proposed solution	Workgroup
5. Next steps	Paul Wheeler
6. AOB & Meeting close	Keren Kelly



SUMMARY OF WORKGROUP 2 AND ACTIONS

P426 Workgroup 2 Summary (1 of 3)

- P426 Workgroup 2 was held on 7 September 2022
- Overview of Payment and Credit Default process
 - Elxon explained the timescales and consequences of entering Credit Default depending on the level, and also Payment Default and the Payment Default Timings
 - Elxon also explained the triggers of Default set out in [BSC Section H 'General'](#)
- Development of proposed solution
 - The development of the proposed solution section of the Workgroup meeting was covered in three sections;
 - Defining the entities;
 - Provision of Credit Cover; and
 - Governance and process.
 - This further developed the solution as introduced and discussed at Workgroup meeting 1

P426 Workgroup 2 Summary (2 of 3)

- **Defining the entities**
 - Elxon explained:
 - practically the solution should only apply to BSC Parties as BSCCo has authority over BSC Parties;
 - the legal risks of the proposed solution; and
 - the need to ensure that proposed solution was not masking bad debt.
 - The Proposer was open at this stage to the solution applying to Parties in the same group or two or more unrelated Parties
- **Provision of Credit Cover**
 - Elxon explained that the combining of Credit Cover can either be done at the beginning or end of the process but that the recommendation was to combine at the end as less impact on document and system changes, and also Energy Indebtedness for individual Parties would still be visible in the background
 - Elxon proposed that if one Party in the partnership (two or more Parties) were to enter liquidation, then the partnership in terms of combining Credit Cover will end and the enduring Party would need to provide collateral to cover their position within 1WD, ideally cash, which can subsequently be replaced with a Letter of Credit
 - The Workgroup were invited to consider risk mitigations for discussion at the next Workgroup meeting
 - Elxon explained that it would be the responsibility of Parties combining their Credit Cover to ensure that their bank or insurance providers arranging their Credit are able to provide for all combined Parties, otherwise single Party rules would apply

P426 Workgroup 2 Summary (3 of 3)

- **Governance and process**

- Elexon explained that each Party entering into an arrangement would need to consent and sharing will not be effective until all Parties have separately notified the change
- A Workgroup Member raised a concern that if non-cash collateral were provided there may be a risk that the underwriter (the bank or insurance provider) refuses to pay if the collateral is called upon by BSCCo
- A Workgroup Member made the point that the underwriter of the collateral (bank or insurance provider) may charge a premium for arranging Credit under a combined relationship and this cost may outweigh the benefit of the proposed Modification
- As the discussion was covering Credit arrangements, Elexon took the opportunity to promote a new BSC Issue which is due to be raised soon to review BSC Credit Cover arrangements, for which P426 Workgroup Members and others may be interested in joining

- **Progression Plan & Next Steps**

- Elexon explained that the BSC Panel had approved an extension to the P426 Assessment Procedure at its meeting on 14 July 2022
- The P426 Assessment Report is therefore due to be presented at the February 2023 Panel meeting, or earlier if possible
- This will be post Assessment Procedure Consultation being issued to industry and a Workgroup meeting will be required to consider consultation responses

P426 Workgroup 2 Actions

1. Workgroup Members to consider risk mitigation for the proposed solution in advance of or at the next Workgroup meeting, to support the Proposer
2. Elexon and the Proposer to consider the 1WD grace period for a single BSC Party to provide Credit collateral to cover their exposure in the event of their combined Credit Cover relationship with another Party being terminated due to the other Party's liquidation
3. Elexon to consider the wording of a clause in the Letter of Credit template to reference bilateral arrangements
4. Elexon to consider the risk that Parties enter liquidation at the same time, in addition to the scenario discussed where only one of the Parties enter liquidation
5. The Proposer to provide clarity on whether the solution should apply to Parties who are part of the same group only, or also to those who do not have an existing relationship, to then allow Elexon and the Workgroup to further develop the solution
6. Elexon to further develop the P426 solution based on feedback and discussion by the Workgroup, for consideration at the next Workgroup meeting



RISK MITIGATIONS



MITIGATING ACTIONS

Overview

- **Reminder:**
 - Two or more Parties will be able to combine their TEI and combine their Credit; they can be either part of the same group, or separate (Proposer confirmed this post-WG2)
 - The solution will only be of use where the net indebtedness is less than the sum of individual indebtedness i.e. one Party is positive, and another is negative, therefore reducing overall indebtedness
 - If the amount of 'cash' lodged is less than the outstanding Trading Charges, then there is a risk on other Parties having to subsume costs
 - As requested by the WG previously, we have curated potential mitigating actions

Overarching Principles

- Guiding principle is that combining Credit should be part of a business plan, not a short term fix to address credit issues
- Intentionally difficult; bureaucracy and delay to deter 'quick win' actions
- References to 'cash' are collectively, cash, credit notes or insurance
- We have assumed the Credit Committee will make decisions, but this may be the Panel - We would welcome WG thoughts and/or consultation feedback
- Grouped into five main areas:
 - Eligibility;
 - Application;
 - Rules Changes (other actions will require rules changes, these suggestions don't fit elsewhere);
 - Monitoring; and
 - Default Actions.
- Listed 'positives' and 'negatives' are initial starting points for discussion and not definitive as consecutive bullet points



DATA FOR CONTEXT

Energy Indebtedness data

- The Total Credit we hold as of 1st Sep 2022 = just over £1,786 Bn
- Two week period up to 9 October 2022
- Excludes NGESO and 0 MWh volumes (roughly half)
- Value = TEI*CAP (CAP = £500/MWh)

Values for all Periods

(MWh)	All TEI	Positive TEI	Value (PositiveTEI)	Negative TEI
Mean	-1,761.85	7,177.82	£3,588,908.88	-9,588.17
Median	-0.50	988.81	£494,403.05	-1,130.82
Maximum	-	105,864.74	£52,932,370.00	-280,562.60
Total	-6,288,047.67	11,958,244.40	£5,979,122,198.20 (£5.98 Bn)	-18,246,292.06

Values for all Party Id i.e. net positions

MWh	All	Positive	Value	Negative
Mean	-28,429.85	107,504.85	£53,752,425.57	-128984.29
Median	-77.14	13,368.71	£6,684,353.68	-7383.44
Maximum	-	1,344,242.72	£672,121,358.10	-3807697.32
Total	-7,221,182.63	11,610,523.92	5,805,261,961.55 (£5.81 Bn)	-18831706.55



ELIGIBILITY

Eligibility suggestions

- Bespoke scoring for quantitative assessment - Develop scoring matrix to give some qualitative guidance to CC; could be done by CC or PAB
 - Removes some level of subjectivity from CC members and provides some justification to their decision
 - Would take time to develop and be resource intensive for BSCCo to develop, monitor and report could be seen as being a bit too onerous
 - Administrative processes that could be automated. Content and scoring is subject to discussion – may need to bring in specialist consultants
- Cash flow has to exceed Trading Charges - CC could set margin (including 0%) to be exceeded for Party with largest TEI over previous
 - Ensures that the companies involved have sufficient income to remain viable
 - Potential concerns about commercial confidentiality. CC may not be qualified to make such assessments. Cash flow may not necessarily reflect ability to pay if cash is funnelled elsewhere. We don't ask other Parties this, so could be seen as discriminatory
 - Training to understand cash flow and ability to pay. Will be presented alongside application and reviews at CC, so ties-in with effort for those meetings
- Credit rating - CC may ask applicants to provide a credit rating from a recognised credit agency
 - Allows CC to assess risk of default if 'cash pot' is less than we would have otherwise been, and therefore risk of defaulting
 - Potential concerns about commercial confidentiality. CC is not qualified to make such assessments
 - Training to understand what credit ratings are and how they are formed and impacts on cash flow. Will be presented alongside application and reviews at CC, so ties-in with effort for those meetings

Eligibility suggestions

- Default free history - No defaults for either Party in previous 14 months; CC discretion can be exercised; CC could also include other Codes/Ofgem a/r
 - Previous compliance can be indicative of future compliance and give some assurance that risk of default is reduced
 - Longevity doesn't always relate to viability, particular when the market is in churn and volatile
 - Minimal – will need to run a report during the application process and for routine reviews
- Hedging strategies - CC may call upon CFO to provide high-level details of Hedging strategies
 - Allows CC to assess risk of default if 'cash pot' is less than we would have otherwise been, and therefore risk of defaulting
 - Potential concerns about commercial confidentiality. CC is not qualified to make such assessments
 - Training to understand hedging strategies and impacts on cash flow. Will be presented alongside application and reviews at CC, so ties-in with effort for those meetings
- Minimum trading period - Either a minimum term e.g. 5 years of trading, or sufficient time to prove themselves viable – CC discretion
 - Longevity can be a link to viability
 - Longevity doesn't always relate to viability, particular when the market is in churn and volatile
 - Minimal – there is a certain amount of (collective) subjectivity, so consulting could mitigate this

Eligibility suggestions

- Liquidity - Applicant CFOs must demonstrate ability to liquidate assets quickly if required to cover indebtedness
 - Will give assurance that company can raise funds relatively easily in the event of default, and therefore cover their debts
 - Could be seen as being overkill, and if a company is entering insolvency, would be irrelevant as we may be down the list for the administrator
 - Training to understand liquidation processes, unless it is taken on trust. Minimal otherwise as onus will be on the applicant
- Minimum period for sharing credit - Have to share credit for period to be set by CC and subject to review
 - Step towards ensuring parties don't rush into arrangements
 - Doesn't allow companies to move quickly if the market changes
 - Would need adding to BSC and System change so that 'split' occurs after date into System
- Only allow I+C/mixed Suppliers - Restrict participation as domestic-only Suppliers are higher risk
 - Domestic Suppliers are the most likely to fail, causing mutualisation; reduces risk of mutualisation if all costs can't be covered
 - Recommendation is based on historical events – volatility of market could make the assumption for this action unnecessary. Also, fairness between Parties
 - Would need fool-proof way to determine non-domestic Suppliers. Would then need System change and Code change. Would need to monitor in case Supplier becomes domestic only
- Overall indebtedness - Show they have manageable debts elsewhere that won't impact cash flow
 - Allows CC to assess risk of default if 'cash pot' is less than we would have otherwise
 - Potential concerns about commercial confidentiality. CC is not qualified to make such assessments
 - Training to understand financial statements. Will be presented alongside application and reviews at CC, so ties-in with effort for those meetings

Eligibility suggestions

- Financial Health of company - Applicants will need to report things such as: dividend payments; borrowing, repurchase of shares; profits; net worth; Shareholder's funds; Working Capital Ratio etc.
 - CC can determine how many years reports to look at
 - Allows CC to assess risk of default if 'cash pot' is less than we would have otherwise been, and therefore risk of defaulting
 - Potential concerns about commercial confidentiality; Training to understand financial statements, ratios and company financial health; Will be presented alongside application and reviews at CC, so ties-in with effort for those meetings
- Parties should be connected - There should be some sort of connection between Parties i.e. part of the same group
 - Ensures that both Parties have an interest in supporting each other
 - If the Group fails, increases chances of multiple Party failures
 - Will need to formally identify connections. Will need System changes to prompt further rules
- Parties should have an arrangement between them - If Parties are not connected by Group, there needs to be some formal arrangement between the two to confirm their arrangement
 - Gives assurance around mutual awareness
 - Doesn't really have too much legal value
 - Will need to formally identify connections. Will need System changes to prompt further rules



JOINING & LEAVING PROCESSES

Starting + Ending process suggestions

- Appeals process - All CC decisions should be subject to review by the BSC Panel; Panel decision to be subject to consultation
 - Good governance and ensures CC can be held accountable
 - Could be used to delay change of status by another Party
 - Administrative impact on BSCCo to prepare for BSC Panel, and follow-on actions
- Application and Cooling-off period before breakaway - Parties must inform CC they intend to separate, there will then be a 14 Calendar Day cooling off period – CC discretionary
 - This is another process to ensure that changing status and the associated effort is a considered decision, and not a 'quick-fix'. CC can block change if it will result in a default, for example
 - Could be seen as excessive administration when companies are changing to be like other parties
 - Systems change for status. BSC Change and internal processes. BSCCo could take as a paper to CC, no need for Parties to attend
- CC approval to combine TEI - Applicants will need to present their case to the Credit Committee (CC) before they can combine credit
 - Gives industry representatives opportunity to safeguard Parties' interests
 - Isn't full proof and codifies what is intended to be a business decision
 - Relatively simple – Could add to CC ToR, or Codify if required
- Formal request from CFOs or equivalent - The application should be signed by the CFO, even if someone else progresses the work
 - Gives gravitas to situation and ties in with making this a business decision, not part of a commercial strategy
 - Ties-in with removing flexibility that would allow companies to react to changing market forces
 - Resource requirement for BSCCo to review and help prepare for CC

Starting + Ending process suggestions

- **Open reporting of application** - All application documentation and relevant CC minutes to be published as part of post-CC consultation – use BSC Open Data principles
 - Forces applicants to consider implications of combining indebtedness; Transparency is a means to avoid insider trading
 - Potential mitigating action to release documents could be resource excessive
 - Administrative task for BSCCo, would need to be approved by BMRS Change Board (BCB) or CC; Potentially set-up means to alert Ofgem for REMIT monitoring
- **Open reporting of arrangement** - Combining of indebtedness (not actual amount) to be published on BMRS
 - Allows potential counter parties to consider risk of joint default
 - Not treating all Parties equally and could impact price of contracts
 - Will need system change for BMRS – new field for notifications
- **Post-approval cooling-off period** - Any approval won't become effective for 10 WD after decision
 - Long process helps to ensure that this option is used as part of a business model rather than a short-term solution to debt risk
 - Stretching out process could add risk to Supplier facing financial difficulties in, or out of the BSC
 - Relatively simple. Would need adding to the BSC and internal process. System change to reflect cooling-off period
- **Post-CC consultation** - CC gives initial minded to decision before issuing a consultation on CC's minded-to position
 - Allows industry to give their views and check the CC. Ties-in with other Panel decisions
 - Would need to be carefully worded to ensure Parties act in industry interest
 - Relatively simple. Would need adding to the BSC and a consultation template creating. Would need to consider stock questions



RULES CHANGE

Rules Change suggestions

- Circular and BMRS notice - Make it publically known that TEI will be combined
 - Ensures that potential counter parties are aware of position and potential shared impact of failure
 - Could be deemed as unfair treatment of one Party over another by singling them out
 - Create field in BMRS and Circular template (creation and dissolution). Minor resource implication for BSCCo once BAU
- Credit Cover to be more than net Credit Cover - Rather than 'sum TEI x CAP', would be '1.5 x sum TEI highest x CAP' - CC can amend as required
- Using Median values – goes from £494k to £742k – would need 'negative TEI' to reduce 'sum TEI' to 2/3 or less of positive TEI for it still to be worthwhile
 - Reduces risk of 'cash' not being able to cover indebtedness by increasing size of 'pot'
 - Depending on how sums work-out, could result in negating purpose of this solution
 - Change to BSC Systems, change to Code. New rules to run parallel to existing rules in system
- Increased credit period - Will increase amount of cash held to offset
 - If the amount lodged is based on a longer period e.g. 58 days instead of 29, then there is a larger pot of 'cash' to avoid mutualisation
 - Lodging large 'pots of cash' negates the reason for the Modification in the first place
 - System and Code Change will be required to monitor and calculate the amount funds lodged
- Letter of Credit wording - Clause to make it clear that each Party will be covered separately if they split
 - Ensures that if a split occurs, both are covered straight away
 - Only works for Letters and Insurance, not for cash. In the event of insolvency, is practically worthless
 - BSCCo legal will need to review all letters, and could lead to protracted legal back-and-forth. Fully expect Banks to include clauses making it very difficult to enforce

An aerial night view of the London skyline, featuring prominent skyscrapers like the Gherkin and the Shard, with city lights reflecting on the River Thames. The image is split vertically, with the left half showing the city and the right half being a solid teal color.

PERFORMANCE MONITORING

ELEXON

Monitoring performance suggestions

- Largest TEI no more than 25% more than median positive TEI - To be reviewed weekly, limit can be changed by CC – may be used as guide rather than automatic
 - Will give early indication of potential issues if trading is not following normal patterns
 - Surge in TEI may not be indicative of issues, just coincidental, so reacting could cause undue effort
 - To identify occurrences will require system change and/or manual monitoring
- No more than 25% difference in Parties' TEI - Difference based on largest TEI. Percentage difference to be set by CC
 - Will give early indication of unusual trades, which can be a prelude to insolvency
 - May cause undue alarm if the business model is set-up so that a greater difference is normal
 - System change and Rule change. Need to agree actions if 25% is breached. Percentage to be applied to all participants equally, but % level can be changed by CC
- Periodic review - Period to be set by CC when approving - CC review of arrangements to be standing agenda item
 - To review all/some of the eligibility criteria as directed by CC
 - Proactive monitoring of risk to try and capture issues early and reduce risk to other parties
 - Resource impact on BSCCo to prepare reports and papers for CC as well as analysing report
- TEI over previous 5WD compared to normal - TEI over previous 5WD is no more than 25% different from previous 58-day average
 - Early indication of abnormal trading could lead to CC taking action to protect other Parties
 - Even if action is taken, it may not prevent mutualisation – if there's no cash, nothing can be done to cover costs
 - System change to monitor; BSC rule change. Resource impact from having to report and move quickly



DEFAULT ACTIONS

Suggested actions in event of default

- 'Right Thing' emergency breakaway - Allow Parties to forgo 14 Calendar Day cooling off period if this will cause harm to the other Party, or the industry as a whole
 - Allows early action to reduce impacts of potential default and/or insolvency
 - Could be used to avoid cooling-off period and will remove consultation process
 - System change to override 14-day cooling off period. Code Change, process for early engagement and request for emergency breakaway
- CC to suspend sharing at their discretion - CC can suspend sharing at their discretion based on market intelligence or other Monitoring indications – Parties will have right to appeal
 - Allows for early action to prevent bigger issue later
 - Will rely on effective monitoring and CC agreement. If Parties appeal, combined indebtedness should be restored as soon as appeal is determined
 - System changes, rules changes, CC processes
- Cover counter trades - Pot of cash to reimburse some/all counter parties – to be separate to Credit Cover
 - This would ensure that any counter-trades won't suffer from default actions, an issue often identified during defaults
 - This is essentially a second credit cover process and could negate the purpose of combining credit cover
 - Would need to identify and develop process of monitoring trades and calculating amount of cover akin to how we do Credit cover. Would need to determine actual loss for-counter parties if they're able to trade-out their position

Suggested actions in event of default

- Defaulting Party restoration - Non-defaulting Party to be restored after no more than 2WD; CC can use discretion to not suspend trading for non-defaulting Party
 - Allows non-fault Party to restore BAU within a practical timeframe. CC can order it sooner if other monitoring has given indication that it may happen
 - Delay of 2WD could cause unneeded stress on non-fault Party. However, moving sooner may put undue burden on BSCCo while dealing with default and potential liquidation
 - System Changes, Code Change. Resource implication for BSCCo and CC to consider whether to move quicker
- Immediate separation - As soon as one reaches default trip, revert to separate positions and act accordingly
 - Stops any potential bad debt being masked and stops non-defaulting Party being pulled down
 - Could immediately end-up with two Parties in default, and issues with counter-trades
 - System changes and code changes to implement
- One trips, both default - If the TEI for either party reaches 80%, both Parties enter default
 - Collective responsibility and a tool to discourage shifting of debt
 - Each Party is a separate legal entity, so potential for challenge if actions effect solvency
 - System changes and code changes to implement

Suggested actions in event of default

- OSM to prompt early action - OSM to reach out if CCP within 10% of default triggers
 - Allows us to nip an issue in the bud before it becomes a problem
 - Not full proof as a failing business may not be able to stop the decline, so could be superfluous at best
 - Change BSC Systems to create automatic prompt, or ensure OSMs monitor backing data, would need to be mindful of OOH cover and/or long weekends etc.
- Provide collateral - Akin to mortgage collateral – should be equivalent, or greater in value than largest sum TEI over previous 58 days by X% (set by CC)
 - Will allow BSCCo to be able to sell asset to cover costs of defaulting, thus avoiding mutualisation
 - Time to re-sell would leave deficit and losses to be borne by other Parties. Value of collateral may change between transfer and sale, leading to further issues
 - Legalities of entering mortgage-type arrangement will be complicated. Could potentially open us up to legal challenge. Will need to learn new skills to manage onward sale
- Reapplication cooling-off period - CC to set period of not less than 29 days for re-application. CC may require full reapplication or abridged at their discretion
 - Ensures that Parties don't flip-flop in and out of shared cover to hide bad debt, but forms part of a considered business strategy
 - Could be seen as unnecessary administration depending on how it is applied and set-up
 - System change and Code change

Suggested actions in event of default

- Tighter trigger points - Default actions will be taken at 70% & 80% instead of 80% & 90%
 - Forces applicants to consider potential consequences and means earlier actions to prevent defaulting and/or insolvency
 - Potentially unfair treatment of one Party compared to another. Risk of too much oversight/action for what may just be a result of market fluctuations
 - System Changes and Rule Changes. Would emulate existing arrangements (probably)
- Transfer of indebtedness - If one Party enters insolvency, any BSC debt is assumed by the other Party
 - Attempt to avoid mutualisation if credit cover runs out
 - Could lead to other Party defaulting, particularly if they've never had to lodge credit before
 - Need to consider SOLR implications and cut-off of transfer of indebtedness as any imbalance transfers with meters to new Supplier; Potentially complicated System and Code changes to allow for SOLR contingencies too, not to mention system and Code changes to allow for transfer of indebtedness



NEXT STEPS

Next steps

- Workgroup 3 Summary to be issued
- 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 Workgroup 4 (6 to 8 weeks after Workgroup 3)
 - Review Impact assessments
 - Review cost-benefit analysis
 - Agree scope of consultation
 - Gather Workgroup's views
- Plan to issue the Assessment Procedure Consultation following Workgroup 4

MEETING CLOSE

ELEXON

THANK YOU

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20 October 2022