

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

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Workgroup Meeting 2

15 July 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

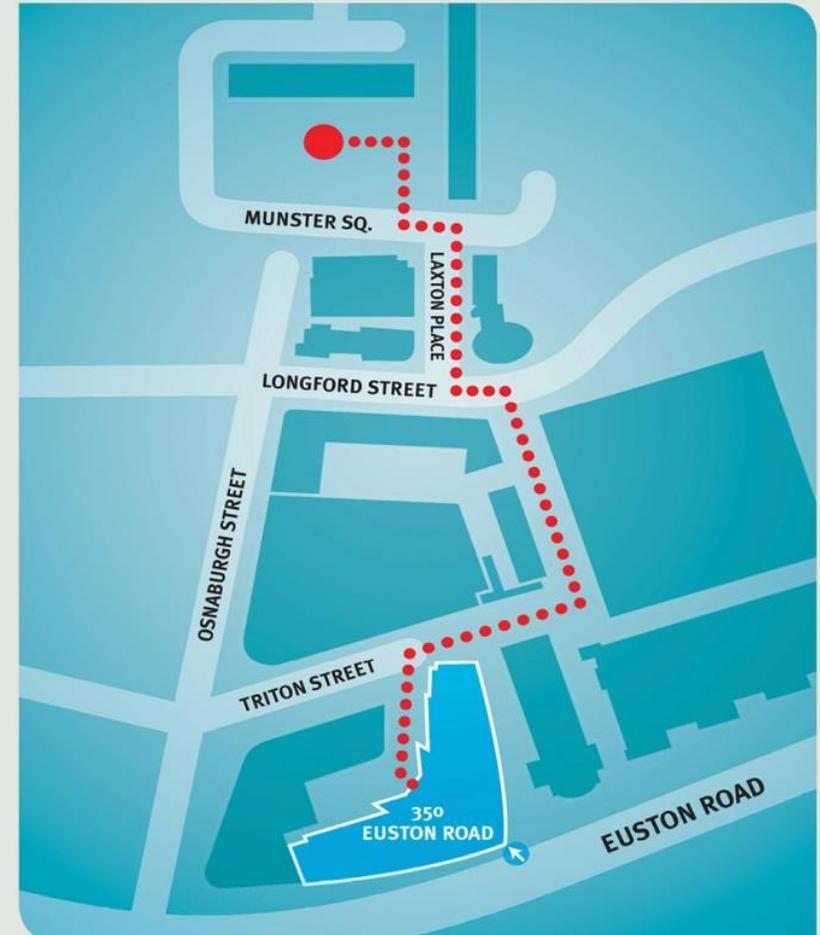
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- Please do not tackle a fire yourself.
- If you hear the alarm, please leave the building immediately.
- Evacuate by the nearest signposted fire exit and walk to the assembly point.
- Please remain with a member of ELEXON staff and await further instructions 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.

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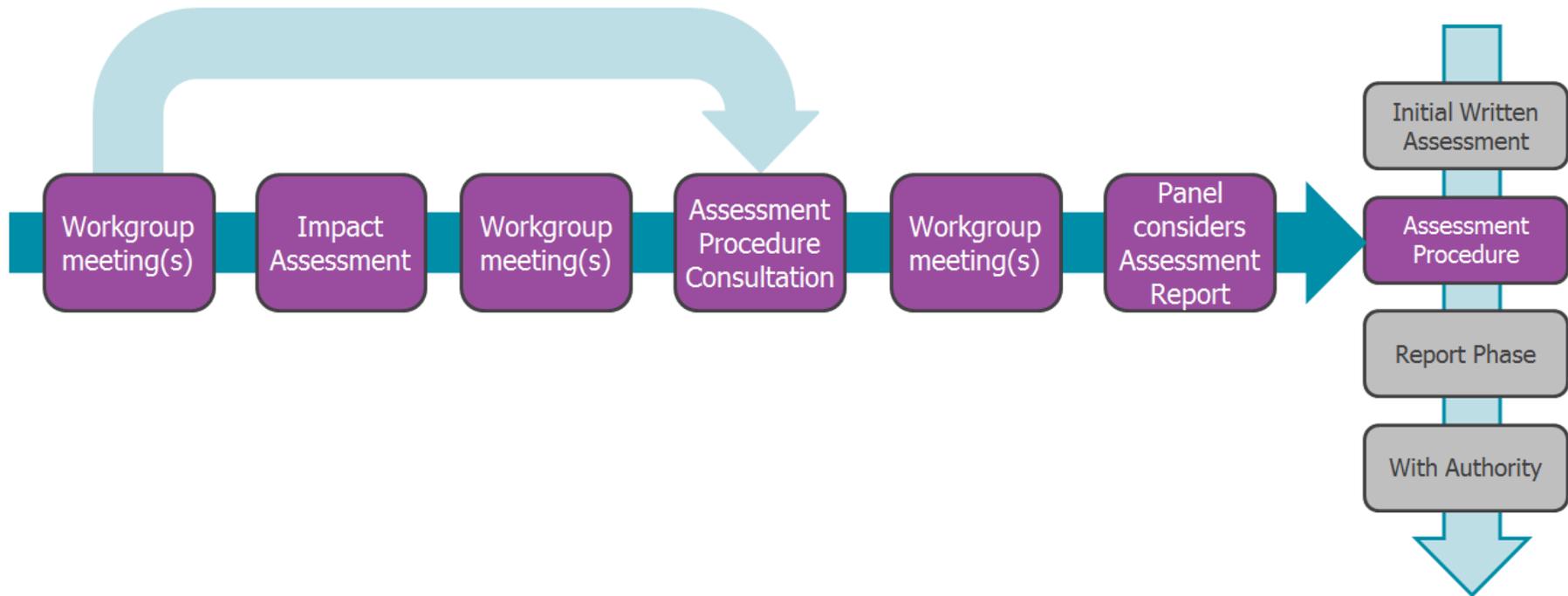


# Meeting Agenda

Agenda item	Lead
<b>1. Welcome and meeting objectives</b>	Lawrence Jones (Chair)
<b>2. First Workgroup meeting summary and actions update</b> <ul style="list-style-type: none"><li>• Clarification on scope of removing Section H parameters</li><li>• Consideration of P188 principles</li><li>• Clarifications on new Payment Default Event of Default</li></ul>	Ivar Macsween (Lead Analyst), Nick Baker (Subject Matter Expert), Workgroup
<b>3. Proposed New BSCCo Charges Event of Default</b>	Nick Baker, Workgroup
<b>4. Discuss Business Requirements and Legal Text</b>	Workgroup
<b>5. Consider Terms of Reference</b> <ul style="list-style-type: none"><li>• Initial views against the Objectives</li></ul>	Workgroup
<b>6. Assessment Procedure Consultation questions</b>	Workgroup
<b>7. Next steps</b>	Ivar Macsween
<b>8. Meeting close</b>	Lawrence Jones

# Meeting Objectives

- Review outcomes of additional actions and analysis by ELEXON;
- Discuss the Legal Text and Business Requirements for P385;
- Address any outstanding Terms of Reference; and
- Agree a solution that can be consulted on.





# Summary of 1<sup>st</sup> Workgroup meeting

## P385: 1<sup>st</sup> Meeting Summary

- Discussions on balancing need for effective EoDs that reduce risk of mutualised bad debt while promoting good performance vs pragmatic considerations.
  - Principle: any amendments to the rules should not present an undue barrier to entry to smaller market participants

Ref	Event of Default	Proposal	Status
EoD1	New 'Payment Default' EoD	Parties failing to pay Trading Charges on time on 3 or more occasions in rolling 30 day calendar period	Clarifications to consider
EoD2	New 'Ceasing to Trade' EoD	Parties who have publically announced they are ceasing to trade	✓
EoD3	Section H 3.1.1 (c) (i) and (ii) 'Credit Default'	Reduction to 10 WDs (Level 1) and 5 WDs (Level ), with no intermittent periods.	P188 principles to consider
EoD4	Section H 3.1.1 (c) (iv) 'Relevant Credit Default Series'	Reduction to 3 occasions in 6 months, on any Level 1 or 2 Credit Default with no cooling off period	✓
EoD5	Section H.3.1.1(b) (iii) 'BSCCo Charge'	Reduction to thresholds for failure to pay BSCCo charges from 15 to 5 Working Days	Additional analysis to consider

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## P385: 1<sup>st</sup> Meeting Outcomes (1 of 3)

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### ■ Proposed new 'Payment Default' Event of Default (EoD1)

- Proposal: New EoD that will trigger in the event that a BSC Party fails to pay Trading Charges on time on 3 or more occasions in a rolling 30 day calendar period.
- Members agreed that application of the Advice Note Threshold was reasonable but noted that the current £500 rate of the Advice Note Threshold should be assessed as part of next review of Specified Charges by ELEXON.

### ■ Proposed new 'Ceasing to Trade' Event of Default (EoD2)

- Proposed new EoD for Parties who have publically announced they are ceasing to trade.
- Members agreed with the intent and application of EoD2.
- Noted that the Energy Act specifies a 14 day notice to the Authority prior to a Supplier entering administration and that this can delay the application of the existing BSC Events of Default.

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## P385: 1<sup>st</sup> Meeting Summary (2 of 3)

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- **Reduction to 'Credit Default' Events of Default - Section H 3.1.1 (c) (i) (EoD3)**
  - Proposal: Reduce the period after which Level 1 and 2 Credit Defaults trigger an EoD to 10 and 5 Working Days respectively, with no intermittent periods.
  - Agreed to remove parameters from Section H 3.1.1 (c) (i) and (ii) and place under Panel control.
  - Is it appropriate to penalise and potentially withdraw trading options for Parties if they have not used up the entirety of their Credit Cover?
  - **Action:** ELEXON to review principles that drove the development of the [P188](#) 'Revision of Credit Default Provisions' solution, for discussion with Workgroup.

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## P385: 1<sup>st</sup> Meeting Summary (3 of 3)

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### ■ Reduction to 'Relevant Credit Default' Series - Section H 3.1.1 (c) (iv) (EoD4)

- Proposed reduction to the Relevant Credit Default Series so that it occurs after 3 occasions in 6 months, on any Level 1 or 2 Credit Default with no cooling off period.
- Members agreed that the solution simplifies the arrangements and for the same reasons as proposed by ELEXON's analysis in WG1.

### ■ Reduction to 'BSCCo Charges' Event of Default - Section H 3.1.1 (b) (iii) (EoD5)

- Proposed reduction to thresholds for the EoD triggered by Parties who fail to pay BSCCo charges from 15 to 5 Working Days.
- The Workgroup questioned whether the reduction would solve the problem.
- **Action:** ELEXON to conduct further analysis and bring an amended proposal back to the Workgroup.



# Actions Update

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# P385: Actions Update Summary

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## ■ **Conclusions of 1<sup>st</sup> P385 meeting:**

1. New 'Payment Default' EoD1 for Parties failing to pay Trading Charges on time on 3 or more occasions in a rolling 30 day calendar period, applying the Advice Note Threshold;
2. New EoD2 for Parties who have publically announced they are ceasing to trade;
3. Reduction to Relevant Credit Default Series so that EoD4 occurs upon 3 occasions in 6 months, on any Level 1 or 2 Credit Default with no cooling off period.

## ■ **To confirm in 2<sup>nd</sup> P385 meeting:**

1. Clarifications on new Payment Default Event of Default EoD1;
2. Whether it is appropriate to alter Section H 3.1.1 (c) (i) and (ii) 'Credit Default' EoD3 in light of P188 principles;
3. Section H.3.1.1(b) (iii) 'BSCCo Charge' EoD5 parameters in light of analysis by ELEXON; and
4. The scope of removing EoD parameters from Section H 3.1.

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## Clarification of Proposed New 'Payment Default' EoD1 (1 of 2)

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- New Event of Default (EoD1) proposed for Parties failing to pay Trading Charges on time on 3 or more occasions in a rolling 30 day calendar period. Failure to pay on time leads to Parties using Credit Cover as a payment method.
  - Previous EoD1 wording: new EoD that will trigger in the event that a BSC Party uses Credit Cover to pay Trading Charges on 3 or more occasions within a rolling 30 calendar day period
- In WG1 ELEXON presented historic Payment Default data from 1 Jan 2017 - 31 Mar 2019.
- Excluding payments under the Advice Note Threshold of £500 (Underpayment, Quarterly Advice Notes) would have caused **57 Events of Default from 37 different Parties.**

## Clarification of Proposed New 'Payment Default' EoD1 (2 of 2)

- ELEXON's WG1 analysis was based on notice of late Payments on D+1. ELEXON proposes to establish a payment deadline of **9am on D+2** for checking if a Payment Default counts towards the new EoD.
- Additional analysis has shown that this would have led to **23 Events of Default from 20 different Parties** between Jan 2017 and Mar 2019.
- 23 Events still included the 12 for failing Suppliers highlighted in WG1

For Discussion...



Are the Workgroup satisfied with these clarifications for EoD1?

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## P385: Panel-set parameters for EoDs

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- **Clarification on scope of replacing the rates for Events of Default with Panel-set parameters**
  - Agreed to remove detail from EoD3 3.1.1 (c) (i) and (ii) 'Credit Default'.
  - In line with P385 implementation, the Panel would agree to amend the parameters based on P385 recommendations (e.g 3 occasions in 6 months).
  - This information published on the BSC website rather than codified in same manner as Section D charges.
  - Would make changes to the rates quicker to amend based on changing market conditions. No Modification required.
  - Responsibility for parameters for EoDs would rest with the Panel. ELEXON would be able to propose changes.

For Discussion...



Is it appropriate to extend this approach to all Events of Default in Section H 3.1?



# **P188 principles in relation to P385**

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## P385: P188 Principles (1 of 3)

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- Following on from [Issue 16 'Credit Default and the Default Provisions in Section H of the BSC'](#), [P188 - 'Revision of Credit Default Provisions'](#) raised on 3 May 2005 by British Gas Trading.
- Aim: to consider whether the provisions, in particular whereby a Party is in Section H default following a defined period of either Level 1 or 2 Credit Default, provided industry participants with an appropriate level of protection at the time.
- P385 Modification Proposal puts forward amendments to reduce the period after which a Party remaining in Level 1 and 2 Credit Defaults trigger an Event of Default.
- In both cases the Party still has a Credit Cover Percentage below 100% and has therefore not reached a net deficit position.

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## P385: P188 Principles (2 of 3)

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- The P188 Workgroup referenced discussions in Modification P188 to this effect as recorded in 1.4.2 of the Assessment Report
  - *"It was also agreed that 100% CCP was an appropriate level to trigger any new provisions, since this is the point at which a Trading Party poses a risk to the market, due to the amount of Credit Cover not exceeding the estimated liabilities."*
- Although Level 1 and Level 2 Credit Defaults may persist, and during this period are notified on the BMRS, it is not until 100% of the Credit Cover is utilised that urgent action is recommended.
- Proposals to reduce duration for Level 1 and Level 2 Event of Default triggers does not align with the P188 principles which still remain relevant. The current rule for 100% CCP to trigger an Event of Default after two Working Days remains appropriate and, operationally, is the Event of Default that triggers the most frequently of the EoDs under the scope of P385.

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## P385: P188 Principles (3 of 3)

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### For Discussion...



1. Do the Workgroup agree with this interpretation of P188 principles?
2. Do the Workgroup agree that the principles remain relevant?
3. Is it appropriate to amend Level 1 and Level 2 Event of Default triggers based on this interpretation?



# **Alternative BSCCo Charges Event of Default**

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## Alternative BSCCo Charge solution (1 of 5)

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- Original proposal: Reduce the thresholds for EoD triggered by Parties who fail to pay BSCCo charges from 15 to 5 Working Days in Section H 3.1.1(b) (iii).
- ELEXON agreed to bring back an amended proposal for the 2<sup>nd</sup> Workgroup meeting.
- Clarification on timescales for payment before EoD is triggered:
  - From Section D 4.5 ‘Invoicing’
  - 4.5.4 The due date of each invoice for BSCCo Charges shall be the 10th Business Day after the date of receipt of the invoice.
  - From Section H 9.2.2 “Such notice shall be deemed to have been received... on the second day following the day of posting
  - In practice this means that Parties have 27 Working Days (12 WDs before notice is deemed to have been received + 15 WDs after this) before triggering EoD in Section H 3.1.1(b) (iii)

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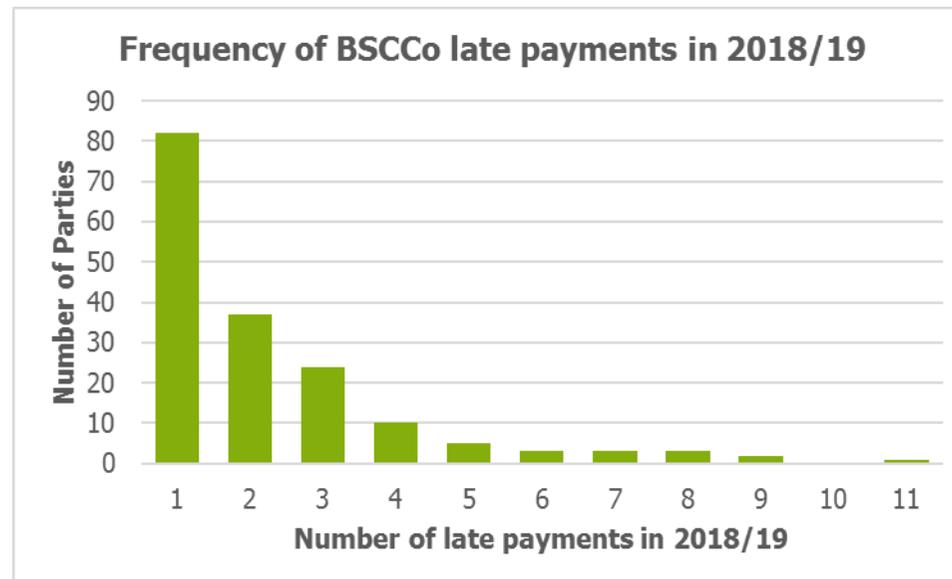
## Alternative BSCCo Charge solution (2 of 5)

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- ELEXON would like to clarify the business need for amendments to EoD5.
- Following WG1, ELEXON have an alternative approach for failure to pay BSCCo Charges, based on the approach determined for new Payment Default EoD (EoD1).
- Would not change rule under 3.1.1(b)(iii) of being in Section H Default for failure to pay in 15 Working Days (as per the original proposal).
- Alternate solution would add in a clause to 3.1.1(b) where 3 late payments in a rolling 12 month Period would constitute an EoD.

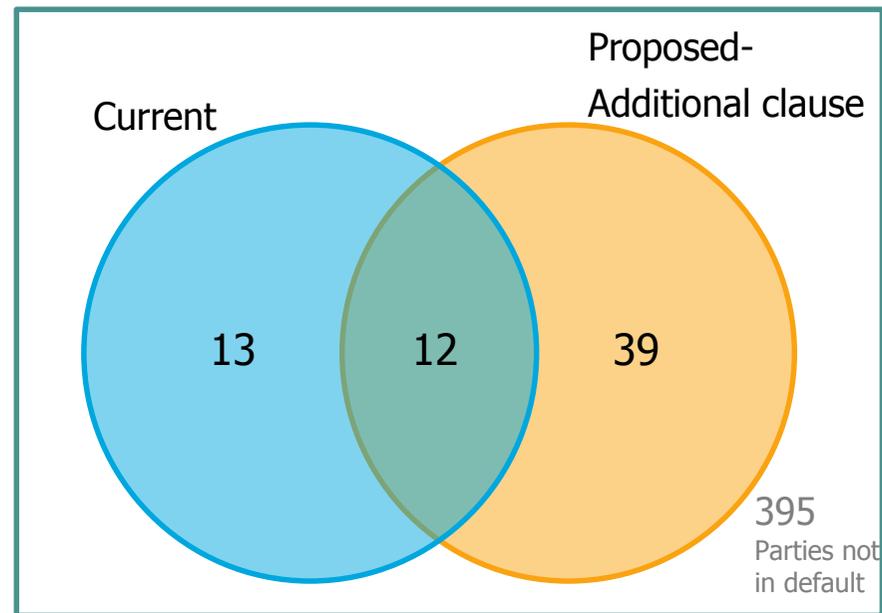
## Alternative BSCCo Charge solution (3 of 5)

- BSCCo Charge payment data analysed for BSC Year 2018/19.
- 51 Parties had 3 or more late payments in 2018/19.
- Average total for 3 late payments is ~£4k
- 301 Parties (64%) had no late payments of BSCCo Charges.



## Alternative BSCCo Charges solution (4 of 5)

- Venn diagram highlights 25 Parties (34 instances) who had an EoD under the current Section H rules for failure to pay 15 WD late and the proposed additional clause of 3 late payments in a 12 month period for 2018/19 (51 Parties, 188 instances).
- 39 new Parties would have had an EoD in relation to failure to pay /late payment of BSCCo Charges in 2018/19.



- 47 Parties had 3 or more late payments in the 2016/17 year and 60 Parties had 3 or more late payments in 2017/18.

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## For Discussion BSCCo Charges solution (5 of 5)

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- For Workgroup discussion:
  - Whether to reduce EoD5 to 5 WDs (from 15) before EoD is triggered; and
  - Whether to add an 'or' clause if Parties fail to pay 3 times in a rolling 12 month period.



# Review Legal Text



# Review Business Requirements



# **P385 Terms of Reference**

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## P385 Workgroup Terms of Reference

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- 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?

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## Standard Terms of Reference

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- 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?

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# ToR (g) - initial views against expected impacts and costs

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## **Costs**

- The central implementation costs for this Modification will be approximately £1680 to make the required document change.
- No system changes are required for this Mod and there will be no impacts on BSC Agents. This is subject to the Workgroup's agreement of the proposed solution.
- ELEXON provisionally estimates 6.5 days effort

## **Likely Impacts**

- BSC Section H
- Impact on Fund Administration Agent (FAA) as BSC Agent. FAA to monitor 30 day rolling period for non-payments as process-only change (no system impact).
- BSC Panel & BSCco
- No anticipated direct impact on BSC Parties (adherence with the rules is expected)



# Applicable BSC Objectives

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## Proposer views against Applicable BSC Objectives (1 of 2)

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- **Objective (c):** there are numerous reasons why 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.

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## Proposer views against Applicable BSC Objectives (2 of 2)

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- **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.
- Neutral on all other Objectives

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# Initial views against the Applicable BSC Objectives

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- a) The efficient discharge by the Transmission Company of the obligations imposed upon it by the Transmission Licence
- b) The efficient, economic and co-ordinated operation of the National Electricity Transmission System
- 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
- d) Promoting efficiency in the implementation of the balancing and settlement arrangements
- 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]
- 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
- g) Compliance with the Transmission Losses Principle



# Consultation Questions

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# Standard Consultation Questions

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## ■ Standard Assessment Procedure Consultation Questions

1. Do you agree with the Workgroup's initial unanimous view that P385 does better facilitate the Applicable BSC Objectives than the current baseline?
2. Do you agree with the Workgroup that the draft legal text delivers the intention of P385?
3. Do you agree with the Workgroup's recommended Implementation Date?
4. Do you agree with the Workgroup that there are no other potential Alternative Modifications within the scope of P385 which would better facilitate the Applicable BSC Objectives?
5. Do you agree that P385 does not meet the Self-Governance Criteria and so should not be progressed as a Self-Governance Modification?
6. Will P385 impact your organisation?
7. Will your organisation incur any costs in implementing P385?
8. How long (from the point of Ofgem approval) would you need to implement P385?

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# Potential Consultation Questions

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- Are there any other questions that should be asked as part of the Assessment Procedure Consultation?
  - E.g Do you agree with the Workgroup that parameters for Events of Default should be placed under Panel control?



**Next steps**

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## P385 Next Steps

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- ELEXON to update Legal Text and Business Requirements
- W/C 22 July: WG review Assessment Procedure Consultation
- W/C 22 July: WG review updated Legal Text and Business Requirements
- W/C 19 Aug: Short Workgroup meeting to review APC responses
- Next meeting could be via teleconference

# P385 Proposed Timetable

Event	Date
Present IWA to Panel	11 April 19
<b>Workgroup meeting 1</b>	<b>17 June 19</b>
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

