Modification Proposal – F76/01	MP No: 188 *(mandatory by BSCCo)*

Title of Modification Proposal *(mandatory by originator)*:

Revision of Credit Default Provisions

Submission Date *(mandatory by originator)*:
3 May 2005

Description of Proposed Modification *(mandatory by originator)*

Section M of the Balancing Settlement Code (BSC) contains the rules for the calculation of a Trading Party's Energy Indebtedness, which is represented by the Credit Cover Percentage (CCP). The BSC does not obligate a Trading Party to lodge a minimum amount of credit cover, however, this is achieved by the use of 2 levels of Credit Default status. Level 1 Credit Default is entered when a Trading Party's CCP exceeds 80 per cent and if it does not claim under the Material Doubt provisions the Trading Party will be placed in Level 1 Credit Default and this notice will not be cancelled until the CCP is not greater than 75 per cent. The second threshold is breached when a Trading Party's CCP exceeds 90 per cent and with ELEXON's authorisation the Trading Party shall be in Level 2 Credit Default. Once a Trading Party has been placed in Level 2 Credit Default the Energy Contract Volume Aggregation Agent (ECVAA) will after a pre-specified number of settlement periods start to reject contract notifications which would not have the effect of decreasing the Party's CCP. The Level 2 Credit Default notice will be cancelled when the Trading Party's CCP becomes not greater than 90 per cent.

A Trading Party can remain in Level 1 Credit Default for a period of 90 continuous days or 120 out of 180 intermittent days and in Level 2 for 65 continuous days or 75 out of 120 intermittent days. During this period a Trading Party can continue to trade, albeit in a limited manner if in Level 2 Credit Default and therefore a Trading Party's CCP can continue to ramp up. There does appear to be a disparity between the treatment of Generators and Suppliers. The provisions contained within Level 2 are much more severe for a Generator as they are prevented from selling electricity. Whereas a Supplier can continue to trade whilst in Level 2 Default and this can result in an increasing Energy Indebtedness. However as long as the Trading Party is paying its Trading Charges no further action can be taken against the Trading Party. Only after a Trading Party has been in default for the periods referenced can the BSC Panel utilise the powers available to it in Section H 3 of the BSC.

British Gas Trading (BGT) initially raised this as an Issue (Issue 16 – Appendix 1) to the Standing Settlement Modification Group (SSMG). The group discussed the issue and agreed there was a defect and that it posed sufficient risk to the market that it warranted further consideration as a Modification Proposal. In raising Issue 16 we identified 4 potential solutions that we believed would address the defect, however the group clearly favoured option 4 which introduces a new process in the event of a Trading Party's CCP exceeding 100 per cent. BGT in raising this proposal are comfortable that the provisions with Section H are sufficiently robust and wide ranging once the criteria specified in Section H have been breached and this allows the BSC Panel to manage the issue. However BGT believe that the

Modification Proposal – F76/01	**MP No: 188** *(mandatory by BSCCo)*

criteria for being placed in Section H Default are too lenient.

Description of Issue or Defect that Modification Proposal Seeks to Address *(mandatory by originator)*

BGT believe that the credit rules in the BSC need to mitigate the credit risk faced by BSC signatories of being exposed to a bad debt whilst not placing overly onerous obligations on Trading Parties when lodging credit. BGT do not believe that the balance under the current baseline is correct and the rules favour a Trading Party whose CCP exceeds 100 per cent. The current baseline attempts to prevent a Trading Party's Energy Indebtedness increasing by rejecting contract notifications that do not decrease indebtedness. However, a Supplier is still able to buy electricity on the assumption that they will purchase sufficient electricity to meet the required level of customer demand. However if the Supplier fails to purchase sufficient electricity to meet its customers demand then its Energy Indebtedness will increase. BGT understands there have been a number of significant instances since the beginning of the year when a Trading Party's CCP has exceeded 100 per cent.

Whilst the Trading Party pays the Trading Charges it has accrued the current rules work. However, if the Party were unable to pay those Trading Charges the likelihood is, there would be insufficient credit cover lodged to pay those charges. Under this scenario the remaining signatories to the BSC would be liable for any shortfall via the funding share mechanism. Which would mean that the industry would assume liability for the bad debt.

Under the current baseline a Trading Party's Energy Indebtedness can continue to increase without check and this can continue for a significant period of time (65 continuous days) before the provisions within Section H can be utilised by the BSC Panel. This poses a real and unnecessary risk to the industry that needs to be addressed.

BGT proposes to mitigate the risk by introducing an additional set of rules that are implemented in the event of a Party's CCP exceeding 100 per cent. In this instance, once the 100 per cent threshold has been breached the Trading Party will have [1] working day to lodge sufficient credit cover or to trade out their position to ensure that their Energy

Modification Proposal – F76/01	**MP No: 188** *(mandatory by BSCCo)*

Indebtedness is not greater then [75] per cent. If the Trading Party does not lodge the required level of credit it will be placed in default in accordance with the provisions within Section H of the BSC. During discussions by the SSMG it was felt that there may be some value in introducing a time band whereby if the same Trading Party breaches 100 per cent on a number of occasions [2] in a [6] month period then the Trading Party would also be placed in default in accordance with Section H of the BSC. BGT agrees with the SSMG and believes there may be some merit in introducing such a window. In raising this Modification Proposal, BGT believe some consideration may need to be given to the interaction with the existing Material Doubt provisions, the Query Period and the default cure period as defined within Section M of the BSC.

Impact on Code *(optional by Originator)*

BGT believe that Section H and M of the BSC will need amending to reflect the rules that will be introduced once a Trading Party's CCP has exceeded 100 per cent.

Impact on Core Industry Documents *(optional by Originator)*

Modification Proposal – F76/01	**MP No: 188** *(mandatory by BSCCo)*

Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties (*optional by originator)*

BGT understands that the ECVAA already provide BSCCo with notification that a Trading Party's CCP has exceeded 100 per cent. Therefore BGT would expect this proposal to have limited impact on BSC systems. Similarly BGT believe that the impact on Other Relevant Systems and Processes used by Parties will also be negligible.

Impact on other Configurable Items (*optional by originator)*

Justification for Proposed Modification with Reference to Applicable BSC Objectives *(mandatory by originator)*

BGT believe this modification proposal will better facilitate Applicable BSC Objective (c) "Promoting effective competition in the generation and supply of electricity and promoting such competition in the sale and purchase of electricity" in the following ways:-

- The current baseline contains a significant risk that BSC Party's could be exposed to a bad debt due to a Party not paying its Trading Charges and their being insufficient credit cover lodged to cover that liability. This liability would be smeared across industry participants via the funding mechanism, primarily on the basis of credited metered volume. BGT do not believe this is consistent with the Ofgem conclusion and proposals document entitled 'Arrangements for gas and electricity network operator credit cover' which stated that the credit arrangements should provide as secure and stable business environment as is reasonable. This Modification Proposal is likely reduce the potential exposure of BSC Parties through the introduction of robust credit arrangements and thereby provide a secure and stable market place.
- This proposed change will also ensure that a Trading Party whose CCP exceeds 100 per cent will be required to post a proportionate level of credit cover that is proportionate to the activities it is undertaking. BGT note the Ofgem decision letter in Network Code (NWC) Modification 0629 which states "Ofgem recognises that as NWC does not currently enable Transco, ... to require shippers to provide a minimum level of security in respect of energy balancing activities, shippers may choose to provide inadequate amounts of security, thereby creating potential community exposure in the event of default." BGT draws a similarly parallel to the BSC and the risks that existed before 0629 are still inherent in the BSC.

Modification Proposal – F76/01	MP No: 188 *(mandatory by BSCCo)*

Details of Proposer:

Name Mark Manley

Organisation British Gas Trading (BGT)

Telephone Number 01753 431137

Email Address mark.manley@centrica.co.uk

Details of Proposer's Representative:

Name Mark Manley

Organisation BGT

Telephone Number 01753 431137

Email address mark.manley@centrica.co.uk

Details of Representative's Alternate:

Name Danielle Lane

Organisation BGT

Telephone Number 01753 431156

Email address danielle.lane@centrica.co.uk

Attachments: Yes

- Copy of Issue 16