

ATTACHMENT A

Justification for Proposed Modification with Reference to Applicable BSC Objectives

Introduction

As set out above, the BSC as currently drafted produces the result that a Trading Party which is in Default under Section H 3.1.1(g) of the BSC can technically never receive its Credit Cover back or even apply for a reduction, notwithstanding the fact that the Settlement Payment Date has passed for its last Settlement Day of trading, it has ceased trading and is unable to trade further, has met all its contractual obligations under the BSC and paid all outstanding invoices promptly (including for that last Settlement Payment Date).

It is submitted that this is an anomaly which operates inequitably, which we assume was not contemplated by the BSC drafters, and which therefore is not (for the reasons detailed further below) in accordance with the Applicable BSC Objectives.

The purpose of Credit Cover and principles of equitable entitlement at English law

The BSC states that Credit Cover is intended to cover Energy Indebtedness (Section M 1.1(b)) only. When a Trading Party has met the conditions set out in (i) to (v) above, it will then have paid the invoice for its last Settlement Day of trading on the Settlement Payment Date and its Energy Indebtedness will amount to zero or less than zero.

Therefore, in accordance with general principles of equitable entitlement at English law, a Trading Party in such a scenario would be prima facie entitled to the return of that Credit Cover, as under the BSC the indebtedness in respect of which the security has been provided has been reduced to zero or less. It is submitted that a result where such security could never be returned to a party in such a position could not have been intended by the drafters and would not be legally possible or justifiable. In addition, this does not accord with the stated policy of the Panel as to how Credit Cover should be calculated. It would be preferable for the BSC to be modified to be consistent on this point and to fix the lacuna rather than raising the possibility of parties seeking equitable remedies with the consequent time and cost implications.

Applicable BSC Objective (c)

The modification would better effect Applicable BSC Objective (c), namely 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, because the lacuna in the BSC constitutes a barrier to entry. The increased exit costs (namely leaving funds trapped as security even after the party in question has stopped trading and reduced its Energy Indebtedness to zero or less than zero) will disincentivise new entrants from joining the market. There is an addition a less direct but material disincentive, in that at a time when the market is short of generation capacity, the status quo is likely to lead to a far greater reluctance for generators to generate at a time when the system may need the capacity and will certainly be a direct disincentive to insolvency practitioners who would otherwise look to create effective, low-risk schemes to allow power stations which technically rank high in the merit order to trade whilst in a receivership or similar situation with the approval of the Panel (as opposed to mothballing). This is also likely to encourage Trading Parties in this position to deliberately minimise the amount of Credit Cover they post, compared to what otherwise might be considered appropriate, creating a greater likelihood of them going into Credit Default. The defect may present serious difficulties for receivers seeking to preserve value in a business, which they are legally obliged to do, by disincentivising them to trade whilst in a receivership.

This lacuna is likely to lead to serious difficulties for (i) receivers, administrators or other

insolvency practitioners who are, broadly speaking, subject to a legal duty to act in the best interests of the relevant creditors which includes proactively gathering in and realising the assets of a Trading Party and (ii) entities who are connected to the relevant Trading Party by virtue of being either lenders or commercial counterparties and who could be relying to a material extent on funds which would have been released in any other circumstances given that the Trading Party has ceased trading but which are now tied up due to a Default which is technical.

The return of funds in accordance with the proposed modification would enable the Trading Party in question to meet outstanding contractual obligations, many of which may be owed to other BSC Parties in accordance with obligations incurred within the BSC framework or with reference to it, which again, it is submitted, gives better effect to Applicable BSC Objective (c).

From a practical perspective, the statistical likelihood of significant variations arising in amounts owed to BSCCo due to the reconciliation process is very low in the case of a generator which meets the conditions set out in (i) to (v) above, although greater variances may occur in the case of suppliers. The position in respect of Trading Disputes remains by its nature somewhat intangible, while the PNE Claims position has been clarified to some extent. In all these cases, however, it seems clear based on the BSC (a position reaffirmed in Elexon's report on Modification Proposal P132) that the Panel has accepted the position that Credit Cover is not intended to cover any of these potential claims in the case of a Trading Party which ceases trading. It therefore seems inequitable to require a Party which is in technical Default (and generally in the position described above) to underwrite this risk when no other Party (regardless of its financial position or its ability to meet PNE Claims or a claim arising from a Trading Dispute) is required to do so. We would submit that given the modification ensures consistent treatment of Credit Cover calculations in this area it further reflects Applicable BSC Objective (c).

Applicable BSC Objective (d)

The modification is also likely to more effectively promote Applicable BSC Objective (d), namely efficiency in the implementation and administration of the balancing and settlement arrangements, in that it will reduce the need for parties to seek their remedies in alternative fora (and outside the BSC) which would otherwise have material time and cost implications not only for the BSC but also for BSCCo which would have to deal with any such applications.

We are aware of the status of proposed modification P127, but submit that even if that modification is implemented it will not constitute an equitable, timely or appropriate remedy in light of the concerns detailed above.

It is submitted that in the absence of this modification, Trading Parties in such a position may well refuse to put up the Credit Cover which would be required to trade and forgo real opportunities to produce the income needed to meet their commitments to their counterparties, many of which will be other BSC Parties, and that therefore this modification will be of real benefit to the industry and its participants, particularly in the current market situation. In particular, the risk of suppliers failing to meet their contractual commitments following a decision not to trade could produce significant harmful effects across a range of counterparties.

In conclusion, this proposed modification would encourage Trading Parties (be they generators or suppliers) which are technically excellent but which find themselves in

administrative receivership or a similar position to trade (with the Panel's permission) under the BSC and promote competition, undertake a sales process to introduce new players into the market and withdraw in an orderly fashion having paid all accrued Trading Charges and met all other contractual obligations under the BSC.

ⁱ Please note that in the context of this Modification Proposal, "trading" means trading through the submission of Energy Contract Volume Notifications, Metered Volume Reallocation Notifications, participating in the Bid-Offer process or carrying out any other activity which leads to changes in any Energy Account of that Trading Party (which changes are not caused by factors outside of the Trading Party's control, such as the reconciliation process). The reference to a party having ceased all forms of trading is also intended to refer to future trading, and we acknowledge that there may be circumstances in which it is deemed appropriate to obtain some form of comfort that no such future trading will occur.