

Issue 16 – Credit Default and the Default provisions in Section H of the BSC

Background

The BSC contains the rules for the provision of credit cover and the calculation of a BSC party's Energy Indebtedness. The rules contain credit default provisions to mitigate the industry from being exposed to a bad debt. There are 2 levels of credit default, level 1 when a party's Credit Cover Percentage (CCP) becomes greater than 80 per cent. The Party then has a 24-hour query period from the point at which the CCP exceeds that threshold. At the end of the period if the CCP has dropped below 80 per cent or within the default cure period 75 per cent the notice is cancelled. If the CCP does not fall below these levels then the party is placed in level 1 credit default at the end of the Default Cure Period. A party will cease to be in Level 1 credit default if its CCP falls below 75 per cent. The party can remain within level 1 credit default for a period of 90 continuous days or any intermittent period of 120 out 180 days before it is in default under Section H of the BSC and the Panel can take any of the actions contained within Section H of the BSC.

If in any settlement period the CCP exceeds 90 per cent then with BSCCo's authorisation the trading party shall be placed in level 2 credit default. When a party is placed in level 2 credit default the ECVAA will refuse and reject contract notifications, which would not have the effect of decreasing a trading party's energy indebtedness. A party will cease to be in level 2 credit default when the CCP is not greater than 90 per cent. The party can remain within level 2 credit default for a continuous period of 65 days or an intermittent period of 75 out of 120 days before the Panel can take any of the actions contained within Section H of the BSC.

Issue

BGT believe that the arrangements need to mitigate the credit risk faced by BSC signatories of being exposed to a bad debt whilst not placing overly onerous obligations on parties to place credit. BGT do not believe that the balance under the current baseline is correct. In raising this issue the message that we are trying to put across is to ensure that all parties should post a commensurate level of credit cover that provides industry participants with an appropriate level of protection.

BGT do not believe that a trading party should be able to remain within either level of credit default for such a prolonged period. BGT believe that this significantly increases the risks of a trading party racking up a liability that is in excess of the credit cover lodged. If the party cannot pay those liabilities accrued in respect of its trading charges this will be smeared back amongst existing BSC parties on the basis of the funding share.

In raising this issue BGT believe consideration should be given to the following areas:

- 1- Whether the current provisions for dealing with persistent or recurring Level 1 or 2 Credit Default provide industry participants with an appropriate level of protection; and
- 2- Whether the current provisions under Section H provide an appropriate level of protection to industry participants when applied in the case of persistent or recurring Level 1 or 2 Credit Default.

Possible Solutions

The first solution is to significantly reduce the amount of time a party can remain in level 1 and 2 credit default from the current baseline. This could take the form of 45 continuous days or any intermittent period of 60 out of 90 days for level 1 credit default. For level 2 it could be 30 continuous days or 45 out of 60 days for level 2.

The second solution could involve a party being in default as specified in Section H, 5 working days following the query period after a party has entered level 1 credit default. This would allow a party 5 working days within which to lodge more credit cover, this would be in addition to the query period and in essence is an extension of the existing cure period. A party that has misjudged its credit requirements should be able to lodge the additional credit cover required within that period.

The third potential solution could introduce a model similar to that utilised in the gas market, a change that was recently implemented by NWC Modification 629. The model would have to have different

timescales due to the respective duration of the settlement periods in gas and electricity. BGT propose that if a Party enters level 1 credit default on 4 separate days during a rolling 29 day period then the party would be obligated to lodge additional credit cover as calculated by BSCCo based on the best data set available at the time – this would be a defined calculation and would form part of any modification raised. The additional credit cover request would be to ensure that there is sufficient 'headroom' in respect of a party's peak indebtedness. e.g. the gas arrangements work to ensure that there is always a minimum of 15% protection to the industry. In gas you receive a cash call (requirement to lodge more credit) if your indebtedness exceeds 85%, so if you breach 85% twice in a rolling 29 day period you receive a request to lodge additional credit. That is based upon your peak indebtedness over the previous 28 days. If that was 89% and you had lodged £100 credit cover initially you would be required to post £104 and maintain that for a minimum period of 90 days. This then acts as an incentive to ensure that the party lodges a representative amount of credit. Built within this process would be an appeals mechanism that would allow the party to dispute the level of assessed credit and why that level was inappropriate. If the party refused to provide additional credit then it would be in default under Section H of the BSC.

The fourth potential option would be to introduce an additional set of rules that are implemented when a party's indebtedness exceeds 100%. In this instance if the 100% threshold is breached a party has 1 working day to lodge sufficient credit cover to take the indebtedness below 75%. If the party chooses not to lodge that additional credit cover the party is placed in default in relation to Section H.