

Assessment Procedure Consultation Responses

P307 'Amendments to Credit Default arrangements'

This Assessment Procedure Consultation was issued on 12 September 2014, with responses invited by 10 October 2014.

ELEXON

What stage is this document in the process?

01 Initial Written Assessment

02 Definition Procedure

03 Assessment Procedure

04 Report Phase

Consultation Respondents

Respondent	No. of Parties/Non-Parties Represented	Role(s) Represented
TMA Data Management Ltd	0 / 1	Supplier Agent
Haven Power	1 / 0	Supplier
Opus Energy	3 / 0	Supplier
E.ON UK	1 / 0	Generator, Supplier, Interconnector User, Non Physical Trader
Good Energy Limited	1 / 0	Supplier, ECVNA, MVRNA
IBM UK Ltd on behalf of ScottishPower group	9 / 0	Generator, Supplier, Distributor, Non Physical Trader, ECVNA, MVRNA, Supplier Agent
RWE npower	1 / 0	Supplier
EDF Energy	10 / 0	Generator, Supplier

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Question 1: Do you agree with the Workgroup's initial unanimous view that P307 does better facilitate the Applicable BSC Objectives than the current baseline?

Summary

Yes	No	Neutral/No Comment	Other
8	0	0	0

Responses

Respondent	Response	Rationale
TMA Data Management Ltd	Yes	-
Haven Power	Yes	-
Opus Energy	Yes	The current system means that if a BSC party breaches a default threshold at the weekend their only option to improve their credit position is to trade. Most small suppliers are unable to trade at weekends as they do not have the 24/7 trading operations of larger parties. This could leave them with no possible means of rectifying the situation before entering formal default with the severe consequences that entails. Implementing this modification would therefore facilitate objective c) effective competition by allowing all parties the option to rectify breaches before entering formal default.
E.ON UK	Yes	Reducing the levels of excess Credit Cover that participants need to lodge, and the costs associated with doing so, would better facilitate competition. Allowing more time to manage a Credit Default and the removal of the Level 2 Cure Period will better facilitate efficiency in the BSC arrangements.
Good Energy Limited	Yes	Increasing the duration of the Query Period so that it applies for a minimum of 5 business hours may encourage some participants who do not trade outside of business hours to reduce the level of credit cover lodged because they have more time to place credit cover in response to increases in indebtedness outside of business hours. This may better facilitate competition & reduce slightly the levels of excess credit cover lodged, thereby facilitating Applicable Objectives (c) & (d). However, we believe that 5 business hours is too short to have much impact in that respect.

Respondent	Response	Rationale
IBM UK Ltd on behalf of ScottishPower group	Yes	The current Credit Default processes do incentivise over-security, and the proposed changes would allow for more flexibility, especially for smaller Parties. Ensuring the inclusion of business hours within the Query Period is an obvious win, allowing the Party to actually lodge more credit. We agree with the workgroups arguments on Objectives c and d.
RWE npower	Yes	Agree with the workgroup's view that this modification would better facilitate BSC objectives C & D. We believe these changes would potentially encourage BSC parties to reduce their current credit cover positions (especially the amounts currently in place to mitigate any 'tail risk' which needs to be considered under the prevailing rules) as a result reducing credit cover costs hence promoting competition in the market. Also by allowing more business hours (i.e five consecutive hours) to a party who is in breach would give them a fair and reasonable time to respond to a breach notice and rectify the position without exposing other BSC parties into any undue risk which would better facilitate efficiency in the BSC arrangements.
EDF Energy	Yes	We note that the Workgroup believes P307 better facilitates Applicable BSC Objectives (c) and (d). The current provision, in baseline BSC, whereby a default notice can be issued (where a Party's Credit Cover Percentage in any Settlement Period becomes greater than 80%) in circumstances (on a Friday evening) where there are no Business Hours available to resolve the issue before being publicly declared in default by the start of business on a Monday morning, is particularly difficult for smaller players which have difficulty accurately finessing their credit cover. It is however, also adverse for all players of any size – it is not normally possible to increase the size of a letter of credit, or move cash into the collateral cover account, outside of working hours. The current BSC therefore adversely incentivises Parties to lodge higher amounts of Credit Cover to avoid the consequences of default over a weekend. The proposed solution would extend the Query Period in these circumstances such that the Query Period would always include a minimum of five consecutive business hours . This removes an unreasonable risk to BSC parties, without (other than infinitesimally) increasing the risk to other BSC Parties of charges to them due to

Respondent	Response	Rationale
		<p>unsecured losses arising from defaults by others.</p> <p>We therefore believe that BSC P307 would, based on the observations above, better facilitate the following applicable BSC objectives:</p> <p>Applicable BSC objective (c) 'promoting effective competition in the generation and supply of electricity, and applicable BSC objective (d) 'promoting efficiency in the implementation and administration of the balancing and settlement arrangements'</p>

Question 2: Do you believe the Workgroup's potential alternative solution would better facilitate the Applicable BSC Objectives than the proposed solution and so should be raised as an Alternative Modification?

Summary

Yes	No	Neutral/No Comment	Other
5	1	1	1

Responses

Respondent	Response	Rationale
TMA Data Management Ltd	Yes	The potential alternative solution is a more robust solution and better delivers the Applicable BSC Objectives c and d. A single threshold would be easier to administer which better delivers Applicable BSC Objective D. Raising the threshold to slightly reduce the level of coverage needed by existing Suppliers and new entrant Suppliers would have more of an impact on the competition in the Supply of Electricity, aiding in better delivering Applicable BSC Objective C.
Haven Power	Yes	Yes. We agree that although the alternative would be a more robust solution, understand why it has not been adopted at this time, as it would complicate and dilute the original solution. We would be supportive of this change as a future modification in 6 to 12 months but at this current time, do not want to risk making P307 any more convoluted for the Panel and Authority than it needs to be.
Opus Energy	Neutral	The main benefit of the modification is the workings hours change. The alternative conserves this element of the solution and is therefore functional in that respect. However, the alternative is quite wide ranging and we do not feel in a position to judge whether the rest of the wider changes are beneficial or not compared to the original modification.
E.ON UK	No	Extending the Query Period by too long could allow the exposure of a genuine risk to grow.
Good Energy Limited	Yes	Increasing the duration of the Query Period so that it applies for the duration of 2 business days (potential alternative solution) rather than a minimum of 5 business hours (P307 proposed solution) is more likely to encourage some participants who do not trade outside of business

Respondent	Response	Rationale
		hours to reduce the level of credit cover lodged, because they have more time to place credit cover in response to increases in indebtedness. Hence the potential alternative solution would better facilitate Applicable Objectives (c) & (d) than the P307 proposed solution. Increasing the credit default threshold to 90% should further reduce levels of excess credit cover lodged, which is likely to benefit small participants relatively more than larger ones because for small participants it is more likely to free up cash than for larger ones who are able to lodge most of the credit cover as letters of credit. Hence this results in the potential alternative solution better facilitating Applicable Objectives (c) & (d) further than the P307 proposed solution.
IBM UK Ltd on behalf of ScottishPower group	Yes	The Alternative solution is simpler and more straight-forward to understand and follow. It would be more efficient to administer, and so, while the arguments against Objectives c and d are the same as the Proposed, the effect of the Alternative is more magnified.
RWE npower	Yes	<p>The alternative solution would be looking to achieve a much wider reform to the energy balancing credit cover default process compared to the proposed solution. We believe the changes proposed in the alternative solution would help to reduce some of the complexities and constraints within the current credit default process. A single trigger point (i.e 90%) with longer query period and clear consequences if unable to manage the position within the given time frame would potentially benefit more BSC parties as they would be able to manage their credit cover position in a more efficient and cost effective way hence would promote competition in the industry. This alternative solution would probably benefit smaller parties in the industry who would have no/ limited trading activities during weekends etc hence allowing them to better manage a credit cover breach.</p> <p>However, we would like to highlight the fact that it would be vital to understand that the alternative solution would not expose BSC parties to any significant additional risk over and above the equivalent risk exposure under the original proposed solution.</p>
EDF Energy	Unsure	We understand that the potential alternative would raise the trigger that commences a query period, from 80% to 90%. If any party's CCP exceeds the

Respondent	Response	Rationale
		<p>90% trigger, a Party would be given a Query Period which would end at 17:00 on the second full Working Day following notification of the breach. We are not currently convinced of the need to raise the trigger to a new single trigger of 90%. If a Party breaches the 80% trigger threshold then it is likely it would breach the 100% threshold shortly after, and we would not want the effective notice, to be shortened.</p> <p>It would be useful if analysis could be done (recognising if you change incentives then behaviours change) on the impact of changing from 80% to 90%, i.e. how many companies historically re-secured their position after exceeding 80% and how many after 90%. If there was found to be a significant difference, then this would indicate that the earlier (at 80%) warning to firms to look into their status, is good for consumers (and industry parties).</p> <p>However, looking at the other element of the possible alternative, we take a positive view of the possibility that the Query Period be extended by another whole working day after the notification of apparent breach, instead of the five business hours in the first working day that the original comprises, to give parties more time to sort things out with their bank (or insurance provider as now allowed under P306, from 14th November).</p>

Question 3: Do you agree with the Workgroup that the draft legal text in Attachments A and B delivers the intention of P307?

Summary

Yes	No	Neutral/No Comment	Other
5	0	3	0

Responses

Respondent	Response	Rationale
TMA Data Management Ltd	Yes	-
Haven Power	Yes	-
Opus Energy	-	-
E.ON UK	Yes	The draft legal text clearly sets out the new process.
Good Energy Limited	-	We have no comment on the draft legal text.
IBM UK Ltd on behalf of ScottishPower group	Yes	-
RWE npower	-	We have not review the legal text from a legal perspective
EDF Energy	Yes	Yes

Question 4: Do you agree with the Workgroup's recommended Implementation Date?

Summary

Yes	No	Neutral/No Comment	Other
8	0	0	0

Responses

Respondent	Response	Rationale
TMA Data Management Ltd	Yes	The sooner the better.
Haven Power	Yes	-
Opus Energy	Yes	-
E.ON UK	Yes	This allows enough time for Elexon to make the necessary changes.
Good Energy Limited	Yes	In view of the potential benefits it is appropriate to implement as part of the next planned BSC Release.
IBM UK Ltd on behalf of ScottishPower group	Yes	-
RWE npower	Yes	We do not anticipate any significant impact on our internal credit cover management process as a result of these proposals (i.e both the original solution and the alternative solution). Therefore, we believe the workgroup's recommended implementation dates subjects authority approval are reasonable and provide sufficient notice to the industry.
EDF Energy	Yes	The Workgroup recommends an Implementation Date for P307 of 25th June 2015 (date of Elexon's June 2015 lumped changes release) if the Authority's decision is received on or before 12 February 2015; or 5th November 2015 (date of Elexon's November 2015 lumped changes release) if the Authority's decision is received after 12th February 2015, but on or before 25th June 2015. These dates are based on the 19 week lead time that would be required to implement the central system changes to deliver either of the solutions to P307. We agree that these are reasonable dates.

Question 5: Do you agree with the Workgroup that there are no other potential Alternative Modifications within the scope of P307 which would better facilitate the Applicable BSC Objectives?

Summary

Yes	No	Neutral/No Comment	Other
8	0	0	0

Responses

Respondent	Response	Rationale
TMA Data Management Ltd	Yes	-
Haven Power	Yes	-
Opus Energy	Yes	-
E.ON UK	Yes	The Workgroup discussed various options before putting forward the proposal and alternative.
Good Energy Limited	Yes	We consider that the Workgroup's potential alternative solution should be progressed because it better facilitates the Applicable BSC Objectives than the P307 proposed solution, as explained above.
IBM UK Ltd on behalf of ScottishPower group	Yes	-
RWE npower	Yes	Agree with Workgroup's view that there are no other potential alternative modifications within the scope of P307 which would serve better the applicable BSC objectives.
EDF Energy	Yes	Yes, but do note our comment on the two elements of the alternative being considered as a possible alternative, in our reply to question 2

Question 6: Will P307 impact your organisation?

Summary

Yes	No	Neutral/No Comment	Other
2	6	0	0

Responses

Respondent	Response	Rationale
TMA Data Management Ltd	No	-
Haven Power	Yes	Yes. We would need to update internal processes and the change may enable us to reduce the amount of credit we are required to lodge.
Opus Energy	Yes	Beneficial to us for reasons stated in 1). It would require minor updates to internal process documents
E.ON UK	No	No, our organisation lodges letters of credit and has strict processes, models and forecasts to ensure that an appropriate level of credit is lodged to never enter default.
Good Energy Limited	No	There would be no implementation or on-going costs associated with either the proposed or proposed alternative solution. Also the proposed solution is unlikely to lead to any reduction in the amount of excess credit cover lodged by Good Energy because with less credit cover in place there is a risk that the person(s) responsible for authorising and lodging additional credit cover may not be available for the transaction to be completed during the minimum Query Period window of only 5 business hours. There is much more likelihood of a reduction in the amount of excess credit cover lodged by Good Energy if the proposed alternative solution was implemented.
IBM UK Ltd on behalf of ScottishPower group	No	-
RWE npower	No	We do not anticipate any significant direct impacts as a result of P307
EDF Energy	No	No significant systems impacts or related costs would arise here

Question 7: Will your organisation incur any costs in implementing P307?

Summary

Yes	No	Neutral/No Comment	Other
1	7	0	0

Responses

Respondent	Response	Rationale
TMA Data Management Ltd	No	-
Haven Power	Yes	Yes. We will incur our proportion of the £49k implementation cost but in the long run, this figure will be negligible. The benefits and assurance granted by the change will outweigh the outlay of investment.
Opus Energy	No	No material cost
E.ON UK	No	It is not anticipated that accepted practice will be changed as a result of the P307 being implemented.
Good Energy Limited	No	-
IBM UK Ltd on behalf of ScottishPower group	No	-
RWE npower	No	We do not anticipate any significant direct impacts as a result of P307 to our internal functionalities hence do not expect any direct costs due to this implementation.
EDF Energy	No	No significant systems impacts or related costs would arise here

Question 8: How much notice of a counterparty entering Credit Default would you realistically require to be able to react accordingly?

Responses

Respondent	Response
TMA Data Management Ltd	No comment.
Haven Power	We would preferably like one working day. This would give us the time to react accordingly.
Opus Energy	-
E.ON UK	As per the current arrangements
Good Energy Limited	We would like to be informed as soon as realistically practicable. Ideally this would be the same day as the default occurred but if the default was minor and the Credit Cover Percentage was not rising steeply a longer notice period would not seem unreasonable – possibly the following day.
IBM UK Ltd on behalf of ScottishPower group	Notice of a counterparty entering Credit Default must always be provided as soon as is practicable.
RWE npower	At the event of a counterparty entering credit default, longer the notice period rest of the BSC parties could get better it will be. The other factor to be considered is the magnitude of the potential impact on rest of the parties in such event. Higher the impact sooner the notice would be welcomed.
EDF Energy	Counterparties ideally need as much notice as possible should an ECVN or MVRN that they are party to is about to be rejected or refused. The proposed solution does not damage this; it is important to bear in mind that if a participant is unable to trade out or otherwise remedy its position over a weekend, then allowing time on the Monday morning to lodge more money before the wider industry becomes aware of the situation is beneficial due to the implications of reputational risk. The wider industry should not be falsely notified when a Party is legitimately in control of the situation (subject to a few working hours' notice).

Question 9: Would you change your behaviour with respect to lodging Credit Cover if P307 was implemented?

Summary

Yes	No	Neutral/No Comment	Other
2	3	2	1

Responses

Respondent	Response	Rationale
TMA Data Management Ltd	N/A	-
Haven Power	Yes	-
Opus Energy	-	-
E.ON UK	No	We have models and forecasts in place to ensure that sufficient credit is lodged at all times without over-securitising. We do however, believe that smaller organisations without similar resources would benefit from the additional time allowed to lodge credit cover in the case of breaching the 80% threshold during non-working hours.
Good Energy Limited	No	The duration of the Query Period needs to be increased to a minimum of 1 business day but preferably 2 business days to provide sufficient time to place credit cover in response to increases in indebtedness.
IBM UK Ltd on behalf of ScottishPower group	No	-
RWE npower	Yes	We believe that we would be looking to lodge a reduced credit cover if P307 gets implemented as we would not have to be too concerned about the 'tail risk' knowing that we would get sufficient time under P307 to manage a credit cover breach at the event of that happening during a weekend/Christmas holiday season.
EDF Energy	Maybe	It would reduce a potential incentive to conservatively over-securitise

Question 10: Do you have any further comments on P307?

Summary

Yes	No
1	7

Responses

Respondent	Response	Comments
TMA Data Management Ltd	No	-
Haven Power	No	-
Opus Energy	No	-
E.ON UK	No	-
Good Energy Limited	Yes	We believe that participants would be more likely to reduce excess credit cover lodged if Elexon was obligated to actively monitor all participants' Credit Cover and giving any participant early warning if it is felt that its Credit Cover Percentage is rising too fast or getting too close to the applicable threshold. This would provide participants with much more reassurance than any such monitoring presently undertaken as 'good working practice'.
IBM UK Ltd on behalf of ScottishPower group	No	-
RWE npower	No	No further comments
EDF Energy	No	-