

244/14 – PAYMENT DEFAULT AND QUARTERLY ADVICE NOTES

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Purpose of paper Information

Classification Public

Summary Following the quarterly Advice Note trigger on 3 July 2015, there were 22 Payment Defaults. Five of the defaults should have been Default Funding Shared and two were Events of Default. Where payment is not received within two Business Days the BSC requires the outstanding amounts to be “mutualised” amongst BSC Parties based on their Default Funding Share. Due to the low value of the sums involved and because payment is imminent, it is both costly and inefficient for these invoices to be mutualised. This paper informs the Panel of operational practice for Payment Default events and invites discussion on low value Payment Default events.

1. What are Advice Notes?

- 1.1 Advice Notes¹ are invoices for Trading Charges and Reconciliation Charges. Each day, if the Advice Note value is above a +/- £500 threshold it is released. Otherwise it will accumulate over a number of days until it breaches the threshold or reaches the quarter end.
- 1.2 The process for quarterly Advice Note trigger was introduced in November 2008 through [Modification P214 – Issues Relating to Funds Administration](#). The principal driver for this was a reduction in the transactional costs of market participation. Prior to November 2008 BSC Parties received daily Advice Notes, often for small and even penny invoices. Once an Advice Note is released, it has a payment due date three Business Days later.
- 1.3 [Section N](#) of the BSC determines the obligations for clearing, invoicing and payment with regards to Trading Charges and Reconciliation Charges. This section includes the production of Advice Notes and actions to be taken for unpaid Advice Notes.

2. What is a Payment Default?

- 2.1 Payment Default is an event where a BSC Party does not pay its Advice Note within three Business Days. The BSC specifies a day by day process for Payment Default in section N.9. This refers to the payment due date as the Affected Date (D). We then count working days after the Affected Date D as D+1 (+1 Business Day), D+2 (+2 Business Days) etc.
- 2.2 At D+1, the Party is notified of the Payment Default. There is a theoretical reduction in the Credit Cover.
- 2.3 By 17.00 on D+2 the Credit Cover is drawn down. In some cases a Party may have zero or less Credit Cover than the amount due. Where insufficient funds are available a Default Funding Share (DFS) is applied.

¹ a note issued by the FAA on a Notification Date setting out amounts payable by or to a Payment Party on the relevant Payment Date in accordance with Section N7.1.1.

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- 2.4 At D+3 the non-paying Party triggers an Event of Default under BSC Section H. To which the Panel can consider a number of resolutions, from notifying all BSC Parties to expulsion.
- 2.5 Where a BSC Party has sufficient Credit Cover to cover the payment, ELEXON can defer action to D+5. This is particularly useful for cases where calling on a Letter of Credit would incur the BSC Party significant administration fees.

3. How would a Default Funding Share work?

- 3.1 A DFS apportions an unpaid Advice Note across Parties. The DFS percentage is calculated from the total BSC Costs paid by a BSC Party. Because of the way that DFS is calculated, Parties who are not actively trading, and so would not expect to pay Trading Charges, can pay a share of any Trading Charges defaulted by another Party.
- 3.2 Taking an example where the Party has no Credit Cover. A DFS would be applied on D+2. This would be claimed on Advice Notes at D+3. Parties that have a share of the unpaid amount will be informed of the defaulting Party ID on their next Advice Notes. This could be any date from D+3 to the next quarter end. The standard three Business Day payment deadline would apply once the Advice Note is triggered.
- 3.3 Note that not all Parties are informed; some may not have a large enough DFS to be allocated a portion of the unpaid Advice Note. For example a £0.07 Advice Note would DFS across three of the largest Suppliers, with £0.01 each initially. The remainder of £0.04 is then allocated to the largest Party.

4. What if the payment is received after the Default Funding Share?

- 4.1 In the event that the non-paying Party makes payment, the DFS can be reversed. This can only happen after the earliest payment date for the DFS has passed, in this case D+6. At D+7 the DFS reverse can be applied to Advice Notes due for payment at D+10.

5. Example of recent quarter end Payment Defaults?

- 5.1 When the quarter end trigger occurs, the Parties are sent an additional email to remind them to pay. This is not a BSC obligation. This is a friendly reminder as they may not have had an Advice Note for three months or more. It also recommends the use of Direct Debit or cash Credit Cover for future Advice Notes of this kind.
- 5.2 Please see appendix 1 for a table view of this event. For quarter 1 of this BSC Year, the quarterly trigger occurred on 30 June 2015. The Payment Date was 3 July 2015. There were 22 Payment Defaults at D+1. With the exception of one daily Advice Note (paid at D+1), the remaining 21 Advice Notes totalled £958.
- 5.3 Seven of the Parties had cash Credit Cover. The Credit Cover was used at D+2. The remaining 14 Parties had no Credit Cover. Five paid at D+1 and four paid at D+2. Leaving the remaining debt at £326.
- 5.4 Five Parties were allowed to go beyond the D+2 deadline, at which point the DFS should have been applied. ELEXON took the decision to delay action as the Parties were in contact with and had agreed payment with the Funds Administration Agent (FAA). At D+3 further payments reduced the outstanding debt to £107. This was made up of two Advice Notes of which one was for £0.07 (remainder of a partial payment). The Advice Notes were then paid at D+7 with the £0.07 paid at D+15.
- 5.5 The non-payment Parties have not been named in this document to allow for it to be a public paper. Further information can be provided to the Panel in the confidence on request.

6. Rationale for approach taken

- 6.1 Due to the sums of money involved the issue was considered as low risk to BSC Parties. Further, correspondence with the non-paying Parties was positive, with Parties making an effort to pay as soon as

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possible. If DFS was applied, the process to charge and reverse the DFS would elapse 10 working days and provide no benefit to BSC Parties.

- 6.2 Further, the Parties would have been named as defaulting Parties on some Advice Notes. This prompts queries from industry regarding the reason for default. The consequences of publishing a Party ID for a DFS are extreme compared to the value involved.
- 6.3 Notifying the Panel at D+3 to determine Section H Default Resolutions would not be an efficient use of BSC or Panel resources. Particularly where non-paying Parties were active in arranging payment.

7. Next quarterly Advice Note trigger

- 7.1 The next quarter end date is 30 September 2015 with Payment Date 5 October 2015. The D+2 DFS date would be on 7 October 2015 and the D+3 Section H Event of Default on the same day as the October Panel, 8 October 2015.

8. Further considerations

- 8.1 ELEXON, as BSCCo should deliver BSC obligations for Payment Default as required by the BSC. All Advice Notes unpaid at D+2 where the Party has no Credit Cover should be DFS. However, due to the low value of the sums involved and because payment is imminent it is both costly and inefficient for these invoices to be mutualised.
- 8.2 Section D of the BSC defines BSC Cost Recovery and Participation Charges. These invoices are monthly amounts for the cost of operating the BSC. In the event of non-payment the Party is in default after the 15th Business Day. These charges may be considered as lower risk than Trading Charges. In the event of a quarter trigger and the Advice Note being below £500, the Trading Charges are more akin to the Section D charges. In some cases Advice Notes are made up purely of DFS amounts for ongoing defaults.
- 8.3 Section N of the BSC allows three Business Days discretion, but only in the case where Credit Cover is available. If BSCCo had discretion for Advice Notes below say £500 it could avoid unnecessary DFS.
- 8.4 We invite the Panel to note the operational practice applied to recent Payment Defaults. Although not in accordance with the BSC, we believe it is to the benefit of BSC Parties to allow discretion. Discretion should be limited to invoices below say £500 that are triggered at quarter ends. In any case this should not exceed 15 Business Days and the BSC Party must indicate their willingness to pay. In any event and in order to give the Panel full transparency it is proposed that Payment Default events are reported to the Panel.
- 8.5 Ideally the BSC Panel or a BSC Party could raise a Modification to Section N of the BSC to allow for limited discretion by ELEXON.

9. Recommendations

- 9.1 We invite you to:
- NOTE** ELEXON's operation of the Payment Default procedures; and
 - DISCUSS** whether a Default Funding Share after two working days is appropriate for quarter end Advice Notes.

For more information, please contact:

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APPENDIX 1: UNPAID ADVICE NOTES

Date	Day D+	Value of unpaid Advice Notes	No. of Parties in Payment Default
03/07/2015	1	958.68	21
06/07/2015	2	656.08	16
07/07/2015	3	326.60	5
08/07/2015	4	106.81	2
09/07/2015	5	106.81	2
10/07/2015	6	106.81	2
13/07/2015	7	106.81	1
14/07/2015	8	0.07	1
15/07/2015	9	0.07	1
16/07/2015	10	0.07	1
17/07/2015	11	0.07	1
20/07/2015	12	0.07	1
21/07/2015	13	0.07	1
22/07/2015	14	0.07	1
23/07/2015	15	0.07	1
24/07/2015	16	0	0