05/06/2017

**SEMO’s summary responses to issues raised at Meeting 73 and in subsequent written responses on MOD\_02\_17 ‘Unsecured Bad Energy Debt & Unsecured Bad Capacity Debt Timelines’**

***At Modification Committee Meeting 73, with regards to MOD\_02\_17 on the process of Unsecured Bad Debt, SEMO were asked to advise on historic default events in relation to the impact on SEM Creditors. One written response subsequently requested the percentage each unsecured amount which was remedied was of total payments to generators;***

The MO member advised at meeting 73 that they had concerns over the disclosure of data on remedied defaults. This includes providing the figures as a percentage of total generator payments. These concerns remain; however, SEMO can confirm that on review of the five instances where default occurred and was remedied, in two of these instances payment was received the morning after payment was due and three were remedied on the afternoon of the payment due date.

***An action was taken at meeting 73 for members to submit any comments they had on the modification to the Secretariat in writing. Three such responses were received and a summary of the points raised and SEMOs responses are below;***

*Respondent commented that SEMO had been unable to address the lack of resources or modify procedures to shorten the processing timescale.*

SEMO note that the timescale cannot be shortened due to the time taken for the process to complete having been initiated in the systems and that this cannot be changed. In addition, the process for this requires careful checking, review and approval of financials where further efficiencies cannot be made. It is not possible to carry out this process in the circa 2.5 hours which are currently allowed for due to the need for the process and checks to remain robust coupled with the time taken to process in the systems.

*Respondent commented that SEMO had been unable to identify an ability to delay notifying the banks of the payments and still facilitate the current payment timelines as the banks have declined to adjust their timeframes;*

It is correct that the banks cannot adjust their timelines in terms of the 14:30 cut off for same day payments; however, we would note that this is due to a cut off set by the central banks and is an universal timeline which applies to all banks rather than a decision by the individual banks themselves. In other words, it is not within their gift to alter this deadline.

*Respondent commented that SEMOs proposal circulated prior to the last meeting suggested that payments could be pushed out further where Debit Note Excess occurred. This was deemed unacceptable due to commitments that SEM Creditors have to make their own onward payments. A number of members commented that they believe this interpretation of the Code to be incorrect.*

SEMO recognises Participant concerns in terms of revenue certainty and onward liquidity and will not pursue the possibility of delaying payments by more than one day, including where Debit Note Excess occurs. That said, if the additional day to process bad debt smearing detailed in the original modification is not approved, SEMO will be in the position of having a codified obligation/deadline which is unachievable.

*Respondent commented that Suppliers would like to avoid triggering the bad debt smearing process where payment rectification is possible and that Generators would like to get paid on the expected day even though it may not be for the expected amount while noting that there is credit/collateral that can be accessed prior to bad debt initiation*

SEMO would not advocate a shortening of the time to remedy from 12:00 on the day after the payment due date as this would increase the likelihood of the bad debt process being required.

SEMO recognise Participant concerns regarding delays in payment. Given that it is not possible to complete the process within 2.5 hours between the calling of bad debt at 12:00 and the banking deadline for same day payments at 14:30 we feel that an extension of one day for payments out less the appropriate adjustments strikes a reasonable balance between ensuring that the codified timelines can be delivered, ensuring that Unsecured Bad Debt is only called where necessary and providing as much revenue certainty as possible to Participants within the constraints of what is practically achievable and robust in terms of ensuring adequate checks and approvals. We also note that all proposed alternatives have been thoroughly investigated at this stage.

Credit (collateral or otherwise) is and will continue to be used to the fullest extent possible under the code. As indicated, Unsecured Bad Debt only occurs where any Shortfall is not met either through payment or Posted Credit Cover or a combination of the two prior to 12:00 the next Working Day in accordance with paragraph 6.54 in the Code.

*Respondent proposed that SEMO could initiate the Bad Debt Smearing Process on the morning of the day after the Payment Due Date and fall back to the original invoice position if payment is received prior to 12:00. If payment does not arrive prior to 12:00 then SEMO could proceed with Unsecured Bad Debt smearing calculations and make same day payments.*

*The respondent also suggested that if it is not possible to fallback to the original position where payment is received prior to 12:00 then SEMO could proceed with the smearing process and resettle the difference between the reduced and original amounts within three days. The respondent felt that this approach would meet the two concerns that Participants have in relation to getting paid on the same day and having the ability to make payment prior to having an Unsecured Bad Debt officially declared.*

*The respondent went on to state that they understand that this approach may lead to more smearing events, however, the generators believe that they shall get their full payment as long as all suppliers make their payments. Generators are willing to endure reduced payments (after smearing) to ensure the majority of payment is received on the expected day.*

*Another respondent stated that this suggestion tabled to initiate bad debt smearing prior to the time to remedy deadline has merit and should be investigated; however, they also stated that suppliers would still expect to be allowed to rectify a payment issue by 12:00 on the day after the due date.*

It is not possible for the smearing process to be reversed once it is initiated. There is also no provision in the Code for SEMO to smear a Shortfall which is remedied prior to 12:00 the following day since this does not meet the definition of Unsecured Bad Debt.

SEMO are not in favour of an approach which requires the smearing process to be carried out where a Shortfall is remedied even where this is done without the official declaration of an Unsecured Bad Debt. This approach would increase the likelihood of having to carry out the smearing process as noted by the respondent. It would also require further modification of the Code as the provision to smear Shortfalls only applies where Unsecured Bad Debt is in effect.

*Respondent commented that if the smearing process identifies a Debit Note Excess for a Generator then the posted credit for that Generator should be used to cover that Shortfall*

It is up to individual Excess Participants to either pay such an excess or request that SEMO draw down on excess collateral where this exists. Where such a request is received and sufficient collateral is in place the posted credit will be used.

*Respondent stated that they would encourage SEMO to review the specification and testing of the ISEM section of the T&SC to ensure that the system build allows for processing of unsecured bad debt within timelines. There should be no workaround required within ISEM;*

SEMO note that the approach for ISEM has been dealt with via the project work streams. The issues identified during consideration of this modification have been communicated to the appropriate teams to ensure that they do not recur in ISEM. The extra day proposed in this modification will apply to the current SEM only and there is currently no intention to apply this to ISEM.