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| **Meeting Name** | DCUSA Panel |
| **Meeting Date** | 16 July 2008 |
| **Paper Title** | Recommendation from LORCAA Project Group |
| **Purpose of Paper** | For Information |
| **Synopsis** | This paper sets out the conclusions and recommendations of the LORCAA Project Group. |

## 1 INTRODUCTION

1.1 Schedule 12 of the DCUSA sets out matters for future development by the DCUSA Panel and Parties. The Panel has added each of these items to its work plan and at its meeting in February 2008 agreed to commence work on the List of Registered Credit Assessment Agencies (LORCAA) Project. The Panel established the LORCAA Project Group and developed Terms of Reference for the group which required it to review and develop the arrangements for obtaining the Credit Assessment Score from an Approved Credit Referencing Agency used to determine the Credit Assessment Factor (CAF) for parties who do not have a minimum credit rating of Ba3/BB–.

1.2 This paper sets out the recommendations from the LORCAA Project Group to the DCUSA Panel.

## 2 DCUSA LORCAA PROJECT GROUP

2.1 The LORCAA Project Group met 4 times between 01 April 2008 and 03 June 2008. The Project Group comprised the following members:

- Mike Harding (Chair) - IDNOs
- Donna Townsend - IDNOs
- Edward Coleman – Suppliers
- Keith Munday - Suppliers
- Louise Boland - Suppliers
- Martin Damti – DNOs
- Steve Musiol - DNOs
- Tony Savka – DNOs
- Indra Thillainathan – Ofgem (Observer)

2.2 At its first meeting the LORCAA Project Group agreed that in order to achieve the objectives it would need to understand the processes currently used by DNO Parties, the existing agencies providing the service, Suppliers perception of how the process works currently and, as far as possible, the process used by agencies to provide the rating especially for new Suppliers.

2.3 The Project Group recognised that Distributors currently operate broadly in line with the Best Practice Guidelines issued by Ofgem in 2005 and that differences between the processes are not material. However members agreed that it would be useful to develop as far as possible a transparent and cohesive approach that could be documented in the DCUSA. Members agreed that the drafting should facilitate the consistent treatment of all Suppliers by DNOs.

2.4 Members agreed that the existing DCUSA credit cover processes would provide a solid base for taking the work forward and that the project should seek to develop the existing schedule to add detail and clarity to the credit rating process. Members agreed that any drafting developed should be flexible to address future market developments. The Project Group considered an ENA paper which set out the work the Electricity Network Association's Commercial Operations Group (COG) carried on the credit assessment processes and the recommendations coming out of that activity. It was agreed that the COG document set out the key principles and proposed that the relevant and appropriate parts could form the basis of the drafting for the DCUSA.

## 3 SOLUTIONS CONSIDERED BY THE PROJECT GROUP

3.1 Following discussion the Project Group members concluded that there were 3 options for taking the work forward:

Option 1 – List of agencies and type of reports to be agreed centrally by DCUSA.

3.2 Members agreed that under this model DCUSA Ltd would centrally manage the process and publish the type of report available for each Supplier, but not the detail of the report, on its website. Members agreed that Suppliers would retain the right to select which agency report should be used and that they could choose a different agency or report in different Distribution Areas. The Project Group considered that under this solution Suppliers must retain the right to say whether they wish the rating or their payment record to be used.

3.3 Members considered that there were significant risks associated with Option 1. The group considered how the process would be funded – whether they should be spread equally across Parties, even though the service may not be used equally; or whether a separate cost mechanism would need to be developed. Under the current DCUSA a Supplier can, once a year, request a Distributor to obtain an Independent Credit Assessment from a Recognised Credit Reference Agency selected by the Supplier. The Supplier, at its own cost, can procure further Independent Credit Assessment reports during the year. Members considered whether the Option 1 should be funded either on a transactional basis or centrally funded through the existing DCUSA cost recovery model. They agreed that the mechanism should not discriminate against any category of Party or act as a barrier to entry. The group considered that the most straightforward model would be to base the funding on the existing model – split equally between Suppliers and Distributors and based on market share.

3.4 The Project Group noted that the second risk associated with Option 1 was the liability of DCUSA Ltd to the relevant Parties and the risk associated with the accuracy of the reports. Members considered whether an indemnity clause would need to be drafted in to the DCUSA to limit or restrict action that Parties could take against it for the provision of inaccurate data. The Project Group noted that if the risk was passed from Parties to DCUSA Ltd the costs of centrally managed service would increase significantly.

3.5 The Project Group considered whether the costs of setting up the administration process and DCUSA as the central body for managing the agencies, and the liability issues associated with central service provider, were likely to be greater than any savings for Parties overall.

3.6 The Project Group also considered that there may be a fundamental issue regarding intellectual property rights and the feasibility of the options put forward as Agencies may not be willing to enter into arrangements that ultimately result in a loss of profit and may not agree to the re-distribution of their data.

<u>Option 2 - List of agencies and types of reports to be agreed centrally by DCUSA. Suppliers approach Network Operators separately if/when credit assessments are required.</u>

3.7 Members agreed that this model was closer to the existing process but would provide the structure of a central service body, reduce the risk to Parties and DCUSA Ltd and provide greater clarity and transparency for Parties. There were concerns that using this approach would restrict the agencies that a Supplier could use to those specified in DCUSA and prevent the use of other credible agencies. It was also recognised that DCUSA was by and large an administrative body and that it did not have any decision making powers in this respect. Therefore, any amendments would be subject to the change process.

Option 3 – Process for obtaining agencies and ratings is described by DCUSA but the actual list of agencies and reports is left to the Network Operators to agree bi-laterally with each 'requesting' Supplier.

3.8 Members noted that this option mirrored the current position but would provide greater structure and clarity to Parties through formalising the process in guidance information. However, it was recognised that transparency would be lost if the credit scores of different known agencies was not referenced to a 0 to 10 scale for the purposes of specifying the CAF.

## 4 PROJECT GROUP CONCLUSIONS

4.1 Option 1 was not supported by any member. The group considered that there would be significant work required to introduce central management and the risks associated with liabilities, intellectual property rights, confidentiality and the funding issues were likely to outweigh any benefits to Parties.

4.2 Members considered that both option 2 and 3 had merits and that a hybrid of the two options was the best way forward. Members considered that:

- The process for securing credit references should be formalised in the DCUSA rather than in guidance documentation
- A default list of agencies and products should be contained in the DCUSA but that Users should have the right to request that an alternative agency or product be used. Members noted that whilst the DCUSA is subject to change control, the level of change is likely to be low and that

it would benefit Parties to have a benchmark level maintained in the document to add further clarity for Parties and in particular new entrants.

- By including the information in the Agreement it would be easily accessible by industry participants.

4.3 Members agreed that the process in the DCUSA should add clarity and transparency and maintain all the existing obligations. The group noted that this model would minimise the level of change required to the DCUSA and minimise the risk associated with the process. Ofgem confirmed that it was satisfied with the proposed solution and did not consider that it adversely impacted any of the existing agreed processes.

## 5 DCUSA DRAFTING

5.1 The Project Group has developed the initial drafting of changes that would be required to DCUSA in order to implement its proposed solution. The drafting is attached as Appendix A. In accordance with its Terms of Reference the Project Group has not submitted the drafting for legal review. Whilst the current drafting reflects the scope and intent of the work carried out by the group, the drafting can be improved. However, this can be dealt with if and when a formal change proposal is submitted.

5.2 In reviewing the drafting the following concerns were raised:

- The listing of the credit scores were ambiguous at the limits; i.e. limits of 10-20, 20-30… etc. This has been modified to remove the ambiguity. The scores are now drafted as 10-19, 20-29… etc.

- The listing of agencies in Paragraph 2.7A of DCUSA could imply that this was an exclusive list of agencies qualifying as a "Recognised Credit Referencing Agency" and separately that use of the word "Recognised" could be taken to have a broader meaning than the scope of the DCUSA. It was suggested that the term be revised to "DCUSA Recognised Credit Referencing Agency".

- The description of the Logica report in paragraph as a "Bespoke Credit Score and Report" was too broad and could mean any type of report provided at any price.

5.3 It is recommended that these concerns are addressed if and when a formal change proposal is submitted.

## 6 PROJECT GROUP RECOMMENDATIONS

6.1 The Project Group recommends that a Change Proposal should be raised to take forward the work it has developed and that the DCUSA should be updated to in line with its proposed drafting. The Project Group recommends that if the work is taken forward via a Change Proposal all Parties should be given an opportunity to consult on the proposal and that it is subject to full legal review.

## 7 RECOMMENDATION

7.1 The Panel is invited to note the contents of this report.