DCUSA Consultation	At what stage is this document in the process?
# DCP 349 ## Effectiveness of the current provision of unsecured cover under Schedule 1 *Raised on the 10 June 2019 as a Standard Change*	01 – Change Proposal **02 – Consultation** 03 – Change Report 04 – Change Declaration

Purpose of Change Proposal:

The intent of this change proposal is to mitigate the financial risk associated with supply business failures by strengthening the criteria around the provision of unsecured cover and protect customers from increased socialised failure costs.

	The Workgroup recommends that this CP should: proceed to Consultation. Parties are invited to consider the questions set in section 9 and submit comments using the form in Attachment 1 to dcusa@electralink.co.uk by **24 November 2020.** DCP 349 has been designated as a Part 1 Matter and a standard change. The Working Group will consider the consultation responses and determine the appropriate next steps for the progression of the CP.
	Impacted Parties: Suppliers and Distribution Network Operators
	Impacted Clauses: Schedule 1 – Cover

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Any questions?

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Timetable

The timetable for the progression of the CP is as follows:

Change Proposal timetable

Activity	Date
Initial Assessment Report Approved by Panel	17 July 2019
Consultation issued to Parties	10 December 2019
Second consultation issued to Parties	02 November 2020
Change Report issued to Panel	16 December 2020
Change Report issued for Voting	18 December 2020
Party Voting Ends	08 January 2021
Change Declaration Issued to Parties	12 January 2021
Authority Decision	16 February 2021
Implementation	01 April 2021

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1 Summary

What?

1.1. The current arrangements for the provision of unsecured cover need to be reviewed as it has been seen that if, for example, DUoS invoices are being paid on time there isn't a trigger to highlight when a Supplier may be in financial difficulty (or failing to comply with obligations which may result in future failure) until they fail to pay the latest invoice(s) when it is too late. Following a supply business failure outstanding charges are spread across all the other supply businesses impacting customers tariff charges. Coinciding with Ofgem's Supplier Licensing Review and its recent work on Market Entry and Ongoing Requirements for Suppliers we should complement this work by strengthening the criteria around unsecured cover.

Why?

1.2. There have been a significant number of Supply businesses failing which demonstrates increased instability risk amongst Suppliers which imposes costs on other customers. There may be merit in Parties themselves providing increased cover and at present both secured (eg letter of credit or equivalent bank guarantee or a cash deposit) and unsecured cover options are available, including:

- Credit rating from an approved credit referencing agency
- Building up a good payment record

How?

1.3. The proposed solutions contained in the first consultation were as follows:

- Reduce the maximum number of qualifying months of good payment history from 60 to 24 months, together with a time limit after which a form of secured cover must be used e.g. Letter of Credit / Parent Company Guarantee.
- Introduce a common good payment performance matrix to demonstrate the impact late payment could have on the maximum number of qualifying months of good payment history.
- By adopting one of the principles of the Uniform Network Code, which states. "*The Transporter will set the Users Unsecured Credit Limit no higher than the lower of the credit value recommended within the Independent Assessment and the value calculated by applying the Independent Assessment Score to the Transporter's Maximum Unsecured Credit Limit.*"

1.4. Within the consultation responses, some Parties raised concerns that reducing the Good Payment History to 24 months was too much and that perhaps, for example, reducing to 36 months would be more appropriate. There was also concerns raised regarding the new proposal for calculating the Users Unsecured Credit Limit and whether this specific change was required. A majority of respondents were supportive of introducing a common good payment matrix.

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1.5. After consideration, the Working Groups preferred solution is as follows:

- 60 months Good Payment History remains the timeframe, but the value of Cover earned diminishes over the 5 years. At 36 months the value would decrease to 60% of the value earned and after 48 months it would decrease to 30% of the value earned. By the 5-year point either a secured cover arrangement or an acceptable, alternative, unsecured cover arrangement would need to be in place.
- After discussions, the Working Group concluded not to progress the proposed solution regarding changing how the User's Credit Allowance is calculated. The basis of this conclusion was in the majority of cases where a Supplier business had failed the unsecured cover in place was Good Payment History. Consequently, it was deemed that reducing the Good Payment History and in particular mandating that by the 5-year period either a secured cover arrangement or an acceptable, alternative, unsecured cover arrangement is in place would be sufficient to mitigate the financial risk associated with Supplier business failures

1.6. The Working Group is seeking views on this proposed alternative approach.

2 Governance

Justification for Part 1 Matter

2.1. This Change Proposal should be classed as a Part 1 matter since it:

- 9.4.2 (C) it is likely to have a significant impact on competition in the supply of electricity.

Current Next Steps

2.2. This Consultation Document is issued for a period of three weeks. The Working Group will review the responses after this period and decide whether to move to the change report stage.

3 Why Change?

Background of DCP 349

3.1. The above issue was originally raised in DIF 57 'Effectiveness of the current provision of unsecured cover' (Attachment 2). A sub-group of the Standing Issues Group (SIG) was set up to investigate DIF 57. All parties received an invitation to join the group and the group met four times resulting in this change proposal. The group consisted of DNOs, IDNOs and Suppliers.

3.2. The main concern raised was that recent supply business failures have highlighted the need to mitigate this risk as these failures may impose costs on other customers. DIF 57 offered two solutions as below:

- Remove the option for unsecured cover

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- Limit the amount of unsecured cover

3.3. The sub-group was not in favour of just simply removing the option of unsecured cover, it took a more pragmatic approach ensuring different parties views were considered. This Sub-Group led to DCP 349 being raised and the subsequent proposed solutions stated in Section 1 above and in more detail in Section 4 below.

3.4. The main reason for this change is to mitigate the financial risk associated with supply business failures by strengthening the criteria around the provision of unsecured cover and protect customers from increased socialised failure costs.

4 Working Group Assessment

DCP 349 Working Group Assessment

4.1. The DCUSA Panel established a Working Group to assess DCP 349. This Working Group consists of DNOs, Suppliers and Ofgem representatives. Meetings were held in open session and the minutes and papers of each meeting are available on the DCUSA website – www.dcusa.co.uk.

4.2. The Working Group agree that the current arrangements for the provision of unsecured cover need to be reviewed as it has been seen that if, for example, DUoS invoices are being paid on time there isn't a trigger to highlight when a Supplier may be in financial difficulty (or failing to comply with obligations which may result in future failure) until they fail to pay the latest invoice(s) when it is too late.

4.3. The initial concern is that the failure of Suppliers has significantly increased, which demonstrates increased instability risk amongst Suppliers which imposes costs on other customers. Ofgem has been reviewing supplier licensing, which the Working Group believe this CP will complement.

DCP 349 first consultation

Original Proposed Solution

4.4. The Working Group originally consulted on the following solutions:

- The cover that can be earned from building up a good payment history would be reduced from 60 months to 24 months after which time either a secured cover arrangement *or an acceptable, alternative, unsecured cover arrangement* (i.e. credit rating or independent credit assessment) to be put in place;
- Introduction of a common good payment performance matrix to demonstrate the impact late payment could have on the maximum number of qualifying months of good payment history; and
- Implementing one of the principles of the Uniform Network Code, which states. "The Transporter will set the Users Unsecured Credit Limit no higher than the lower of the credit value recommended within the Independent Assessment and the value calculated by applying the Independent Assessment Score to the Transporter's Maximum Unsecured Credit Limit."

4.5. To aid the further development of the solution for this CP, the Working Group issued a consultation to parties on 12 December 2019. The aim of the first consultation was to ask the industry for views

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on the principles of the change and the solution proposed. There were 13 respondents to the first consultation comprising of six distributors, seven suppliers. A copy of the first consultation and the Working Group conclusions can be found as Attachment 3.

4.6. All respondents understood the intent of DCP 349, which was drafted as "to mitigate the financial risk associated with supply business failures by strengthening the criteria around the provision of unsecured cover and protect customers from increased socialised failure costs".

Reduction in Good Payment History

4.7. Regarding the proposed reduction to the cover that can be earned form building up a good payment history approximately half the respondents were supportive, whilst some respondents felt that reducing it to 24 months was too much and there were also concerns that this could make it difficult for new Suppliers to enter the market.

4.8. It was proposed that within six months of earning 24 months' worth of Cover a secured cover arrangement *or an acceptable, alternative, unsecured cover arrangement* (i.e. credit rating or independent credit assessment) would need to be in place. More than half the respondents believed that if this solution was implemented a six-month transitional period would be appropriate, whilst others believed that this was too short and that a minimum of 12 months would be more appropriate.

Common Good Payment Performance Matrix

4.9. The following Good Payment Performance Matrix was proposed in the first consultation:

Age of debt (days)	Value of debt as a percentage of previous month's charges *	Effect on Good Payment Performance
1 to 3	<25%	Loss of 25% of previously accrued Good Payment Performance
	>25% and <75%	Loss of 50% of previously accrued Good Payment Performance
	>75%	Loss of 100% of previously accrued Good Payment Performance
4 and above	Any	Loss of 100% of previously accrued Good Payment Performance

4.10. The above would mean that if the debt was between one and three days old, the loss of previously accrued Good Payment Performance would depend on the value of the debt as a percentage of the previous months charge. If the debt reached four days, then all previously accrued Good Payment Performance would be lost.

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4.11. A majority of the respondents to the first consultation agreed that the above Good Payment Performance Matrix was a sensible approach and would provide consistency across all Licence Areas.

Change to User's Credit Allowance Calculation

4.12. The current process for calculating a User's Credit Allowance provides for a Credit Allowance Factor to be applied to the Credit Rating from an Independent Credit Referencing Agency which results in a significant increase to the overall credit provision.

4.13. To address the issue in paragraph 4.9, the Working Group proposed that, once a User has received an Independent Credit Assessment, it will adopt the following when setting the User's Credit Allowance:

"the Company will set the User's Credit Allowance no higher than the lower of the credit value recommended within the Independent Credit Assessment and the credit value calculated by applying the Credit Allowance Factor"

4.14. Approximately half of the respondents agreed with the proposed approach to set the User's Credit Allowance no higher than the lower of the credit value recommended within the Independent Credit Assessment and the credit value calculated by applying the Credit Allowance Factor. However, some respondents believed that the current arrangements within DCUSA were fit for purpose and that this proposed solution may limit the ability of smaller Suppliers to operate in the market.

4.15. Some respondents were keen to have further information provided to them as to why it is believed the current process for calculating a User's Credit Allowance needs to be amended. It was noted that a similar change has been raised with CUSC (CMP 311 - Reassessment of CUSC credit requirements for Suppliers, specifically for "User Allowed Credit" as defined in Section 3, Part III section 3.27 of the CUSC) and within this Working Group it was identified that the predominant risk is associated with Good Payment History and not the Independent Credit Assessment.

Should this change be implemented retrospectively?

4.16. Within the first consultation respondents were asked whether they believed that this change should be applied retrospectively. The views regarding this were mixed, with some stating that it should be applied retrospectively so that all Suppliers, existing and new will be treated the same and others stated that it would be more simple to apply this to new Suppliers only.

Working Group Conclusions and next steps

4.17. The Working Group identified a number of areas of further work having discussed the parties' responses to the first consultation:

- Review the solution for reduction of Good Payment History based on the consultation feedback
- Review the solution for calculating a User's Credit Allowance and provide justification as to whether this is needed or not.
- Decide on whether any solution should be applied retrospectively or not.

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Revised Options for Good Payment History

4.18. Users can build up Good Payment History by paying monthly invoices on time. The amount of cover that can be earned will differ between distribution services areas but can build up to 60 months' worth. Where Late Payment of an invoice occurs all Good Payment History is lost.

4.19. In the examples below £15,000 has been used as the monthly amount of Cover earned:

Timeframe (months)	Cover Earned
1	£15,000
12	£180,000
24	£360,000
36	£540,000
48	£720,000
60	£900,000

4.20. Considering the feedback from the consultation, the Working Group have considered two variations to the original proposed solution for the amount of cover that can be built up using Good Payment History. These are detailed below:

4.21. Option 1 (current proposal)

- The Good Payment History earned could be reduced to a maximum of 24 months
- Within 6 months of earning 24 months' worth of Cover either a secured cover arrangement or an acceptable, alternative, unsecured cover arrangement would need to be in place.

4.22. Option 2

- The Good Payment History earned could be reduced to a maximum of 36 months
- Within 6 months of earning 24 months' worth of Cover either a secured cover arrangement or an acceptable, alternative, unsecured cover arrangement would need to be in place.

4.23. Option 3

- 60 months remains the timeframe, but the value of Cover earned diminishes over the 5 years as per the below table:

Timeframe (months)	Cover Potential	Cover to be Applied (%)	Cover Earned
1	£15,000	100%	£15,000
12	£180,000	100%	£180,000
24	£360,000	100%	£360,000
36	£540,000	60%	£324,000
48	£720,000	30%	£216,000
60	£900,000	0%	£0

- Therefore, following three years the Good Payment History earned to that point will reduce to 60% of the value and following four years will reduce to 30% of the value.
- By the 5-year point either a secured cover arrangement or an acceptable, alternative, unsecured cover arrangement would need to be in place.

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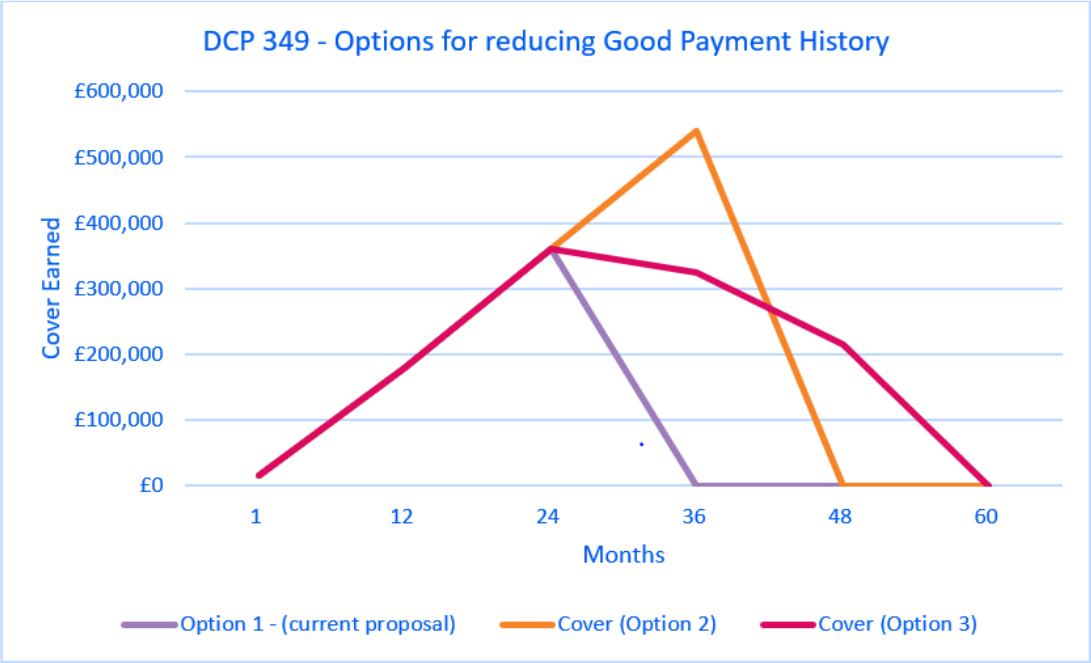

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4.24. After review of the above options, the preferred solution of the Working Group is option 3. It is believed that this addresses some of the concerns raised in the first consultation that reducing to 24 months was too much but also mitigates the financial risk associated with Supplier business failures by strengthening the criteria around the provision of unsecured cover. At present, once a Supplier has built up five years of Good Payment History they can use this cover indefinitely, whereas this change will ensure that after five years a secured cover arrangement or an acceptable, alternative, unsecured cover arrangement would need to be in place. This alternative cover will provide a more accurate reflection of the financial position of the Supplier. This solution also reduces the percentage of cover built up at the end of the third and fourth year.

4.25. The overall timeframe that a Supplier can utilise Good Payment History as cover under Schedule 1 is 60 months. For example, following late payment Good Payment History is lost in line with the Common Good Payment Performance Matrix as detailed within the proposed legal text.

Common Good Payment Performance Matrix

4.26. The Working Group has concluded that the introduction of a common Good Payment Performance Matrix will be of benefit and this will complement the proposed solution above.

Change to User's Credit Allowance Calculation

4.27. After discussions, the Working Group concluded not to progress the proposed solution regarding changing how the User's Credit Allowance is calculated. The basis of this conclusion was in the majority of cases where a Supplier business had failed the unsecured cover in place was Good Payment History. Consequently, it is believed that the proposed solution for Good Payment History mitigates the main financial risk currently imposed on DNOs. It is also believed that either a secured cover arrangement or an acceptable, alternative, unsecured cover arrangement is a better indicator of the financial stability of a Supplier.

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4.28. If the Good Payment History solution is implemented, DNOs will monitor the impact of this and decide post this change whether a change to how the User's Credit Allowance is still required or not.

Should this change be applied retrospectively?

4.29. It is the Working Groups view that this change should be applied retrospectively so that all Suppliers, existing and new will be treated the same. For existing Suppliers, it is proposed that they are given a 12-month transitional period to adjust to the new requirements. For example, if a Supplier has already built up five years Good Payment History and they utilise this as part of their cover, they will need to move to either a secured cover arrangement or an acceptable, alternative, unsecured cover arrangement within 12 months of the implementation of this change. Equally this would apply to any Supplier within the final year of building Good Payment History. All other Suppliers that are currently building Good Payment History would have 12 months to transition to the appropriate stage as detailed in 4.23.

4.30. The Working Group are keen to seek your views on the following:

Q1: Do you agree with the Working Groups view that option 3 detailed in Paragraph 4.23 above regarding Good Payment History is the preferred solution? If not, which solution is your preferred choice?

Q2: Do you agree with the Working Group decision to not pursue a change in the way a User's Credit Allowance is calculated at this stage?

Q3: Do you agree with the Working Groups proposal to implement this change retrospectively?

5 Legal Text

5.1 The amended DCP 349 legal text incorporates the following solutions and can be found in Attachment 4:

- The cover that can be earned from building up a good payment record would remain over a period of five years, however after 36 month the credit built up would reduce to 60% of the value and after 48 months it would reduce to 30% of the value. After five years a secured cover arrangement *or an acceptable, alternative, unsecured cover arrangement* (i.e. credit rating or independent credit assessment) is to be put in place;
- Introduction of a common good payment performance matrix, to demonstrate the impact late payment could have on the maximum number of qualifying months of good payment history, which will complement the proposed solution.

Q4: Do you have any comments on the proposed legal text?

6 Relevant Objectives

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Assessment Against the DCUSA Objectives

6.1 For a DCUSA Change Proposal to be approved it must be demonstrated that it better meets the DCUSA Objectives.

6.2 The Proposer believes that this change in strengthening and streamlining the obligations around the provision of unsecured cover reduces the risk associated with supply business failures, together with the risk of increased socialised costs for customers. This increases the efficient discharge of obligations and indeed efficiency in the implementation of the DCUSA. The effect of this proposal on Suppliers of different sizes will need to be assessed during the Working Group and consultation phase.

	DCUSA General Objectives	Identified impact
☐	1. The development, maintenance and operation by the DNO Parties and IDNO Parties of efficient, co-ordinated, and economical Distribution Networks	None
☐	2. The facilitation of effective competition in the generation and supply of electricity and (so far as is consistent therewith) the promotion of such competition in the sale, distribution and purchase of electricity	None
☒	3. The efficient discharge by the DNO Parties and IDNO Parties of obligations imposed upon them in their Distribution Licences	Positive
☒	4. The promotion of efficiency in the implementation and administration of the DCUSA	Positive
☐	5. Compliance with the Regulation on Cross-Border Exchange in Electricity and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

Q5: Do you believe that the DCUSA General objectives are better facilitated by this CP. Please provide your rationale?

7 Impacts & Other Considerations

Does this Change Proposal impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

7.1 This change proposal coincides with an Ofgem review into its Supplier Licensing regime, which includes the likelihood of increased disclosure from Suppliers with regard to their financial health.

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This could be used by Distribution Businesses to ascertain the likely level of risk involved in extending Supplier credit.

7 Implementation

8.1. If approved, it is proposed that this change should be implemented into DCUSA on 1st April 2021. This would mean that all existing Suppliers would need to transition to the new rules by end of March 2022 at the latest.

Q6: Do you agree with the proposed implementation date?

8 Consultation Questions

9.1. The Working Group is seeking industry views on the following consultation questions:

Number	Questions
1	Do you agree with the Working Groups view that option 3 detailed in Paragraph 4.23 above regarding Good Payment History is the preferred solution? If not, which solution is your preferred choice?
2	Do you agree with the Working Group decision to not pursue a change in the way a User's Credit Allowance is calculated at this stage?
3	Do you agree with the Working Groups proposal to implement this change retrospectively?
4	Do you have any comments on the proposed legal text?
5	Do you believe that the DCUSA General objectives are better facilitated by this CP? Please provide your rationale?
6	Do you agree with the proposed implementation date?
7	Do you have any other comments?

8.2 Responses should be submitted using Attachment 3 to dcusa@electralink.co.uk no later than, 24 November 2020.

8.3 Responses, or any part thereof, can be provided in confidence. Parties are asked to clearly indicate any parts of a response that are to be treated confidentially.

Attachments

- Attachment 1: DCP 349 Consultation Response Form

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- Attachment 2: DIF 57 ‘Effectiveness of the current provision of unsecured cover’
- Attachment 3: First consultation, along with industry feedback and Working Group responses
- Attachment 4: Draft Legal Text
- Attachment 5: DCP 349 Change Proposal

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