DCP 349: Effectiveness of the current provision of unsecured cover under Schedule 1

1. What is DCP 349?

1.1 DCP 349 seeks 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.

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 Supplier 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.

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

1.3 The DCUSA Panel established a Working Group to assess DCP 349. This Working Group consists of DNO, Supplier, IDNO and Ofgem representatives. Meetings are held in open session and the minutes and papers of each meeting are available on here.

2. What is the issue?

2.1 DNOs have stated that in the majority of cases where a supply business has failed the unsecured cover in place was Good Payment History. Consequently, it is believed that the way that Good Payment History is calculated needs to be reviewed to mitigate the main financial risk currently imposed on DNOs. At present, Suppliers can build up a Good Payment History by paying monthly invoices on time. It was recognised that while the amount of cover that can be earned would differ between Distribution Services Areas (DSA) this could currently amount to a maximum of 60 months worth of cover.

2.2 Taking an example of a Supplier being able to earn £15k of cover each month, there is the potential to earn up to £900k worth of credit.

Timeframe (Months)	Cover Earned
1	£15,000
6	£90,000
12	£180,000
18	£270,000
24	£360,000
30	£450,000
36	£540,000
48	£720,000
60	**£900,000**

2.3 Currently, after 60 months worth of credit has been built up, this arrangement can stay in place indefinitely.

3. What is the solution?

3.1 It is proposed that 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

3.2 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 five year point the Supplier must put an alternative form of cover in place, such as a Credit Rating from an Approved Credit Referencing Agency, an Independent Credit Assessment from a Recognised Credit Assessment Agency, Collateral, or a permitted combination

3.3 As previously stated, at present, once a Supplier has built up five years of Good Payment History they can use this cover indefinitely, whereas this solution will ensure that after five years an alternative cover that will provide a more accurate reflection of the financial position of the Supplier will be needed.

Retrospective Implementation

3.4 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.

3.5 On implementation of this change proposal Suppliers using Good Payment History as a form of Cover will be at different stages in the number of months since their earliest Good Payment Performance Start Date, and must be mindful of the timescale involved in having to put in place an alternative form of cover prior to the 60 months threshold being reached.

Good Payment History earned (months)	% of cover earned that applies	Timescale to move to another form of cover (months)
1	100%	59
12	100%	48
24	100%	36
36	60%	24
48	30%	12
60	0%	0

3.6 A supply business can apply 100% of Cover earned up to 36 months, but from that point the value of the cover will reduce to 60% up to 48 months when it will then reduce to 30% up to the threshold of 60 months when it reduces to 0%, by which time a supply business must have another form of cover in place, for example:

- A Supplier with a Good Payment History of 12 months at implementation of DCP 349 would need to be mindful that within 24 months their credit built to that point would reduce to 60% of the value as per the table above.

- A Supplier with a Good Payment History of 36 months at implementation of DCP 349 would still be able to apply 100% of the value of Cover earned, however after a further 12 months their credit built to that point would reduce to 30% of the value as per the table above.

- A supply business with a Good Payment History of 60 months at implementation of DCP 349 would be able to keep the credit built for a period of 12 months by which time an alternative form of cover must be in place, such as a Credit Rating from an Approved Credit Referencing Agency, an Independent Credit Assessment from a Recognised Credit Assessment Agency, Collateral, or a permitted combination.

Good Payment Performance Matrix

3.7 The Working Group proposes to introduce a common good payment performance matrix, which will be implemented upon late payment. The Working Group agreed that this would be sensible as it would ensure that there is a consistent approach across all DSAs. It is proposed that the following would be added into DCUSA:

Age of debt (Working 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

*Total UoS charges and Other charges (if applicable) billed in the previous month

3.8 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.

Legal Text

3.9 The amended DCP 349 legal text incorporates the following solutions and can be found in Attachment 3:

- 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.

4. Supplier Feedback

4.1 The DCP 349 Working Group consulted on the above solution for a period of three weeks from 3rd November and the documentation for this can be found in Attachment 1. The Working Group were concerned that there were not many responses from Suppliers and therefore is keen to seek feedback from Suppliers regarding the above solution. In particular, the following:

- What are your views on the proposed solution? Do you agree that a Credit Rating from an Approved Credit Referencing Agency, an Independent Credit Assessment from a Recognised Credit Assessment Agency, Collateral, or a permitted combination is a better indicator of the financial stability of a Supplier?
- Do you agree with the Working Groups view that this change should be applied retrospectively? Please provide reasons for your response.
- If this change is applied retrospectively, do you agree that a 12 month transitional period is appropriate?
- Do you agree with the Working Groups proposal to introduce a common good payment performance matrix to provide consistency across all DSAs? Please provide reasons for your response.

4.1 Please respond to the above questions by completing the consultation response form found in Attachment 2.

5. Attachments

5.1 Attachment 1: DCP 349 Consultation documentation as issued on 3rd November

5.2 Attachment 2: DCP 349 Consultation response form

5.3 Attachment 3: DCP 349 Legal Text