

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

CONSULTATION 2.1 RESPONSES WITH WORKING GROUP COMMENTS

Company	Confidential/ Anonymous	1. What are your views on the proposed solution? Do you agree that a Credit Rating from an Approved Credit Referencing Agency, and 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?	Working Group Comments
Octopus Energy	Non-confidential	<p>Octopus Energy disagrees with the concept of this proposal which takes a narrow view of credit cover in the energy sector. The premise of the proposal is that approved credit ratings are a better reflection of energy suppliers credit worthiness than the existing contractual framework where (up to) 60 months of perfect payment history is afforded equivalent standing. It is our view that ongoing payments on time every time is a proven factor in illustrating credit worthiness.</p> <p>Whilst we recognise that there is a spectrum of risk across energy suppliers, and there have been many failures over the last two years, we also believe there are some very clear risk indicators, which should provide a sensible basis for differentiating credit terms rather than simply requiring formal 'investment grade status'. For example, considerations might include whether:</p> <ul style="list-style-type: none"> • a supplier hedges their wholesale exposure (perhaps measured by degree of imbalance) • Supplier has wholesale agreements in place to provide market access on favourable credit terms - as well as the benefit of the agreement in itself for supplier liquidity, the supplier performance will be rigorously monitored. 	

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		<ul style="list-style-type: none"> • Supplier has sufficient cash management processes in place that they are able to consistently pay networks on time - history matters. Good payment history demonstrates the suppliers have (a) cash control processes, (b) adequate forecasting and (b) are capitalised to match their growth. These are critical components for any business. • Supplier is able to demonstrate consistent customer satisfaction - we often observe degradation of performance as suppliers become financially distressed (for example, failure to return credit balances quickly upon request or as a result of meaningful price increases etc). <p>All of the above points can be measured and/or provided so as to create a more mature set of credit terms that capture a fuller, more accurate picture of suppliers 'real' risk to the market.</p>	
Anonymous	Confidential	<p>No – we do not agree. In our view the longer a supplier's good payment history, the more its good payment should be trusted. We do not agree that there should be any change from the status quo. The proposals unfairly disadvantage newer suppliers in favour of larger, more established businesses. The proposals will be detrimental to smaller suppliers that have ensured they pay their bills on time in order to reduce their cash credit requirement and in doing so have demonstrated their financial stability. They fails to recognise that credit ratings are not available to smaller suppliers in the same way they are to larger, more established businesses. The proposed transfer of costs and risk from large businesses onto smaller businesses works against the market's need for new entry and innovation. It is also particularly poorly timed given the long-lasting impacts of the pandemic.</p>	

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E (Gas & Electricity) Ltd.	Non-Confidential	<p>It's not clear on the level of supplier engagement received and therefore unclear if all supplier parties are even aware of these proposals.</p> <p>It is our view that Ofgem has already put in satisfactory governance controls and monitoring in place via the Supplier Licence Review and monthly financial RFI requirements to monitor suppliers financial stability.</p>	
So Energy	Non-Confidential	<p>We are against the proposal for the following reasons:</p> <p>As highlighted by Orbit Energy previously, these proposals represent significant and unwarranted costs to the market, far outweighing the cost to suppliers of covering bad debts that have arisen. This cost, which is not included in the default price cap, will have to be passed onto consumers.</p> <p>Moreover, it will harm retail competition, as the burden will disproportionately fall on smaller suppliers who will be less able to bear the costs of the additional credit requirements compared to larger suppliers, who either have the benefit much larger parent companies, additional non-retail operations to rely on or years of having made abnormal profits in a non-competitive environment (this does not necessarily mean larger business have more viable business models but can subsidise / fund retail operations for longer).</p> <p>The end result being that these proposals will increase overall costs and reduce the number of retail suppliers, leading to fewer, larger suppliers and higher costs for customers.</p>	

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		<p>This change does not get at the heart of the underlying issues with the wider market structure which is that large suppliers subsidise exclusive loss-making tariffs for new customers (because of their high-cost operating models) with high variable tariffs for long term loyal customer bases, making it very difficult for new retail suppliers to profitability enter and compete in the market without very significant investment. This proposal will just make the situation worse, with less innovation in the industry and competition brought by new suppliers, both of which negatively impact customers.</p>	
Goto Energy	Non-Confidential	<p>We do not agree with implementation of this change and do not believe the solution resolves the problem as stated in the proposal.</p> <p>We do not agree that the credit ratings would be a viable alternative as private companies would be unfairly disadvantaged. The smaller suppliers would be, as a sector, more adversely impacted than the larger suppliers who will be able to absorb more of the additional costs.</p>	
Pure Planet	Non-Confidential	<p>It is deeply disappointing that there has not been – as far as we have been able to establish – any quantification of the financial impact supplier failure has had on the DNOs. Merely stating that “there have been a significant number of Supply businesses failing” should not be sufficient evidence for such a change which would represent a significant shift in the funding requirement of smaller suppliers.</p> <p>This plays to a wider lack of assessment of the cost of supplier failure to the industry, despite the sudden need to implement additional</p>	

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		<p>regulatory requirements to manage the impact of supplier exit such as Ofgem's Supplier Licensing Review.</p> <p>Only when a fair assessment has been made of the full cost of supplier failure across the DNOs has been provided can the additional costs to the industry of this change be reasonably assessed. We do not believe that this change to the current arrangements should be made until this assessment is completed.</p> <p>Furthermore, we are concerned that any change to the arrangements will affect retail market competition and disproportionately impact smaller suppliers and new entrants who have entered the market based on business plans which took into account DCUSA's rules, which have been in situ for over a decade.</p>	
Working Group Conclusions:			

Company	Confidential/ Anonymous	2. Do you agree with the Working Groups view that this change should be applied retrospectively? Please provide reasons for your response.	Working Group Comments
Octopus Energy	Non-confidential	No. Contractual changes applied retrospectively, creates uncertainty for all parties.	
Anonymous	Confidential	No – as stated above, we do not agree with the proposal. The proposed method of implementation will impose additional calls on cash for smaller suppliers at a time they will already be managing cashflow tightly. This transfer of risk from large to small energy businesses will be detrimental to	

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		new entrants' cash positions, bringing the risk of supplier failure and therefore of knock-on impacts for other non-commodity costs and customer choice.	
E (Gas & Electricity) Ltd.	Non-Confidential	Unclear who the working group consists of and what their interests are in relation to the implementation of this proposal.	
So Energy	Non-Confidential	<p>As noted by SSE Energy supply limited previously, retrospective application will leave the most impacted suppliers with the least amount of time to find collateral. Under the current proposal, an energy supplier that has been operating for 5 years, will have to find relatively the most amount of credit that has been part of its business model (based on decisions taken in good faith based on the rules at the time) for 5+ years in only 12 months.</p> <p>Moreover, given the proposed timing on implementation of 1st April 2021, the negative impacts of COVID-19 on the economy and the time for that to fully unwind in our business, means the timing comes at a particularly poor moment. As SSE Energy pointed out previously, Ofgem has asked suppliers to be more lenient to non-paying customers due to the impacts of COVID-19. In addition, suppliers have faced increased costs due to COVID as a result of energy demand destruction, which was not delayed and hence wasn't able to be fairly recouped, putting on extra pressure, again disproportionately on smaller suppliers.</p>	
Goto Energy	Non-Confidential	It has been argued that retrospective implementation could level the playing field by applying the change equally, but retrospective implementation could disproportionately impact existing suppliers over those that have recently joined the market or new entrants. The suppliers with the largest impact will have the shortest period of time to find alternative arrangements. They have built business models based on the	.

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		existing arrangements in good faith and made timely payments over a period of several years but now face a retrospectively change to their arrangements which would give them a short period of time to arrange alternate sources of cover at a time when finances are strained due to Covid and getting credit will likely to be more difficult.	
Pure Planet	Non-Confidential	<p>No. As noted above, as a bare minimum, an assessment of the costs incurred by network providers as a result of supplier failure set against the impact on existing and future competition in the energy retail market is urgently required before any significant change is made.</p> <p>We're also concerned that implementing any such change in the current economic environment will likely cause significant additional financial burden on supply businesses which otherwise could be perfectly viable. Implementing this change could result in a greater level of cost to the DNOs if it results in supply businesses defaulting ahead of any reduction in their GPH.</p>	
Working Group Conclusions:			

Company	Confidential/ Anonymous	3. If this change is applied retrospectively, do you agree that a 12-month transitional period is appropriate?	Working Group Comments
Octopus Energy	Non-confidential	We disagree with the implementation of this proposal as it stands. If it were to be implemented 'as is' then we would expect to see a glide path between months +12 to month +36 to move away from the existing provisions.	
Anonymous	Confidential	n/a please see above – we do not support this proposal.	

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E (Gas & Electricity) Ltd.	Non-Confidential	No comment.	
So Energy	Non-Confidential	As above, we do not agree with the proposal, being applied retrospectively or the timeframe, which should be significantly longer.	
Goto Energy	Non-Confidential	In the current financial climate, a 12-month implementation period would not be long enough. Especially with the limited number of approved credit agencies that can be used.	
Pure Planet	Non-Confidential	The change should not be applied until a reasonable assessment of the respective costs has been presented. In the current economic environment, a 12 month transition period is far too short. Given the proposal suggests a GPH can be built over 3 years, this would be the most appropriate timeframe over which to implement the change.	
Working Group Conclusions:			

Company	Confidential/Anonymous	4. 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.	Working Group Comments
Octopus Energy	Non-confidential	Consistency would be beneficial for parties when establishing credit arrangements, provided the 'wider' parameters of credit worthiness were equally contemplated when credit terms were being considered.	
Anonymous	Confidential	n/a please see above – we do not support this proposal.	

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E (Gas & Electricity) Ltd.	Non-Confidential	No comment.	
So Energy	Non-Confidential	Yes, we agree with having a consistent approach on this.	
Goto Energy	Non-Confidential	We believe that the introduction of the matrix will introduce consistency across all DSA's and give clarity on the impacts of late payment	
Pure Planet	Non-Confidential	N/A	
Working Group Conclusions:			

Company	Confidential/Anonymous	5. What impact do you think this change would have on retail competition?	Working Group Comments
Octopus Energy	Non-confidential	This change would have a negative impact on retail competition. The principle underpinning this complete shift of historic payment performance reducing credit cover, provides a massive bias towards those businesses with formal investment grade credit ratings, which the former incumbent energy suppliers have, because they were 'gifted' assets at deregulation. This is a vital and unconsidered aspect of the working groups discussion and provides a systematic unfair advantage which challenger suppliers of whichever age or size, will be unable to compete with on anything like a level playing field. For the many suppliers who would need to 'put up' more cash should this proposal be implemented, our initial assessment suggests a £6-£8 per customer per year additional funding	

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		requirement would need to be provided to Network Operators in the absence of formal investment grade ratings.	
Anonymous	Confidential	Negative – by effectively giving established smaller businesses one option for credit cover – cash collateral – this proposal will put pressure on existing independent suppliers and make market entry less attractive. The proposed transfer of costs and risk from large businesses onto smaller businesses works against the market's need for new entry and innovation. Ofgem is already introducing more stringent requirements for suppliers' financial responsibility through the SLR. Those obligations should be relied on to deliver the outcome this proposal tries to achieve, rather than introducing yet another cost on smaller suppliers.	
E (Gas & Electricity) Ltd.	Non-Confidential	This will add further regulation and costs on the retail market and duplication of supplier licence arrangements. Unclear at this stage if the introduction of these requirements could increase supplier failure.	
So Energy	Non-Confidential	As discussed under question 1, we strongly believe it will make it worse.	
Goto Energy	Non-Confidential	There could be a negative impact on competition as a result of this change due to the added pressure on suppliers. There does not seem to have been any additional impact assessment on the change to the market due to Covid 19. Suppliers have the additional financial burden of increasing customer debt along with other charges which have been deferred to be paid in 2021. Although there is a 12-month transition period unless the changes are factored in to the October 2021 price cap suppliers will have little time to reflect any additional costs in to their variable prices (the changes will not be taken in to consideration as part of the April price cap review). For suppliers with customers on longer term fixed contracts these	

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		prices will have been calculated based on the existing arrangements so will not take into account any additional costs.	
Pure Planet	Non-Confidential	<p>This proposal would significantly limit retail competition. By requiring additional capital to be lodged, this will increase the cost of capital and limit the potential for new entrants to the market. The energy supply market is already a low-margin business with significant commodity risks and costs of regulatory compliance. Adding further capital requirements would limit new competition and, in turn, we believe this will act as a significant drag on innovation.</p> <p>Again, quantifying the financial impact of these changes and comparing them with the significant consumer benefits of the increased competition is essential to provide a reasonable, quantitative framework within which to consider this proposal.</p>	
The Working Group Conclusions:			

Company	Confidential/ Anonymous	6. Do you have any other comments?	Working Group Comments
Octopus Energy	Non-confidential	We believe the consideration and management of risk starts from the wrong perspective. Network operators have historically operated a very prescriptive rule set, when it comes to securing against debt exposure, which (currently) prevents them from taking a more nuanced view of counterparty credit risk and ways of securing against it. This proposal increases the discrepancy between credit extended to legacy, former nationalised businesses that were gifted highly inelastic customer-books	

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		<p>that have been managed for value extraction rather than growth or innovation and new, well managed growth businesses that don't yet have credit ratings. Other market participants are able to be more innovative in how they assess and manage credit exposures without just resorting to cash collateralisation, but this proposal just serves to further limit the ways networks interact with their customers.</p> <p>Our recommendation is that the proposal is not implemented but is instead rejected, or at the very least put on ice until the two areas below come into play and the consequences of either/both can be considered prior to any fundamental overhaul of these existing credit terms.</p> <p>i) impact of Covid on potentially distressed suppliers. The Network costs deferral scheme(s) will finish in 2021 and the ability of suppliers to settle these deferred costs will quickly provide visibility on the amount of distress in the industry and the financial protection network operators enjoy from any bad debt (and its subsequent relief which of course will be a pass through cost)</p> <p>ii) introduction of Supplier Licensing review conducted by Ofgem to mitigate against supplier failure.</p> <p>We believe both of these significant benchmarks should 'play out' before proposals such as 0349 are considered for any implementation.</p> <p>As previously mentioned, we do not believe this proposal affords greater ultimate protection for consumers, since it serves to shift costs and risks across the industry which are unproven and untested as to the value in such an approach.</p>	
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Anonymous	Confidential	We are concerned that these proposals have not been communicated sufficiently clearly in the independent supplier community and the timing of the request for this response over the holiday period is likely to mean that there is still insufficient response from the stakeholders most affected. We urge the working group to extend the deadline for responses to the new year and to engage with relevant independent supplier representatives e.g. ICOSS, Cornwall, BEIS/ Ofgem independent supplier forum in order to achieve proper representation and response on these proposals.	
E (Gas & Electricity) Ltd.	Non-Confidential	As a prepayment supplier we are restricted by the price cap allowance. It's unclear from the documentation provided what considerations there has been regarding reflecting any increased costs of administration of the requirements within the price cap.	
So Energy	Non-Confidential	No.	
Goto Energy	Non-Confidential	<p>To date there does not seem to be any information on how much this change will cost to implement and how much (if any) saving it is anticipated this change will deliver. It is unclear exactly how this change proposes to reduce the impact of supplier failures. Although many of the suppliers who have failed had good payment history until they didn't, would have having lower credit cover have prevented them from failing and causing mutualisation of costs or would it have just brought the situation forward?</p> <p>A number of concerns raised by other suppliers in the previous consultation do not appear to have been addressed.</p> <p>As we transition to carbon zero, innovation will be key to driving changes in the way customers engage with their energy use, traditionally those</p>	

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		<p>companies leading innovation will be dissuaded by the high working capital requirements, inevitably delaying products and services that support decarbonisation.</p> <p>It is inevitable that in competitive markets some failures will occur, there will always be bad debts from consumers, and we believe that the enduring Financial Responsibility Principle recently introduced onto licence should be given time to take affect before isolated code requirements are modified.</p>	
Pure Planet	Non-Confidential	<p>We feel that making the change as proposed in the absence of any quantification of the costs and benefits seems, at best, unreasonable.</p> <p>There are already significant collateral requirements across the industry which increase the cost of capital for new entrants. Adding to these will reduce competition and limit innovation, just at a point when the industry is deploying industry transformation programmes such as the Smart rollout and Faster Switching Programme that, at least in part, should offer the opportunity for suppliers to provide greater levels of innovation.</p>	
Working Group Conclusions:			