DCUSA

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 **10th January 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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Contents

1 Summary 3
2 Governance 3
3 Why Change? 4
4 Working Group Assessment 5
5 Legal Text 7
6 Relevant Objectives 8
7 Impacts & Other Considerations 9
8 Implementation 9
9 Consultation Questions 9

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	17th July 2019
Consultation issued to Parties	10th December 2019
Change Report issued to Panel	19th February 2019
Change Report issued for Voting	21st February 2019
Party Voting Ends	13th March 2020
Change Declaration Issued to Parties	17th March 2020
Authority Decision	21st April 2020
Implementation	June 2020

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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. Reduce the maximum amount of qualifying months of good payment history together with a time limit after which a form of secured cover must be used e.g. Letter of Credit / Parent Company Guarantee.

1.4. Introduce a common good payment performance matrix to demonstrate the impact late payment could have on the maximum amount of qualifying months of good payment history.

1.5. 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.*"

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

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2.2. This Consultation Document is issued for a period of three weeks. The Working Group will review the responses after this period.

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
- 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.

3.4. The sub-group looked at the benefit of a Supplier building 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.

3.5. 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. It is possible that a reduction in the number of months earned could be appropriate and 24 months would still provide for £360k in this example:

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**

3.6. It follows that where late payment of an invoice occurs good payment history would be lost .

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3.7. An independent credit assessment can result in a Supplier being afforded significant amounts of credit when the Credit Allowance Factor (CAF) is applied. This credit is also available for each DSA that a particular Supplier trades in; consequently this risk needs to be reduced.

Q1: Do you understand the intent of DCP 349?

Q2: Are you supportive of the principles of DCP 349?

4 Working Group Assessment

DCP 326 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.

Proposed Solution

4.4. The Working Group considered the work completed by the DIF 57 Sub-Group and the proposed solutions as below:

- 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."

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4.5. The Working Group concluded that it would be reasonable to introduce a reduction to the amount of unsecured cover that could be built to 24 months after which a secured cover arrangement or *an acceptable, alternative, unsecured cover arrangement* (i.e. credit rating or independent credit assessment) should be put in place.

4.6. The Working Group agreed that if this solution was implemented, once the 24-month period has been reached, there will need to be a transitional period for Suppliers to put in place their secured cover arrangements *or acceptable, alternative, unsecured cover arrangement* (i.e. credit rating or independent credit assessment). After reviewing the Working Group concluded that a six-month transitional period would be appropriate.

4.7. The Working Group considered the proposed solution of introducing a common good payment performance matrix. 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 (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 <74%	Loss of 50% of previously accrued Good Payment Performance
	>75%	Loss of 100% of previously accrued Good Payment Performance
>4	Any	Loss of 100% of previously accrued Good Payment Performance

4.8. 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.

4.9. 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 Approved Credit Referencing Agency which results in a significant increase to the overall credit provision.

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

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"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"

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

Q3: Do you agree with the proposal to reduce the number of months that unsecured cover can be built from 60 months to 24 months?

Q4: Do you agree that a six months transitional period for Suppliers to put in place their secured cover arrangements *or acceptable, alternative, unsecured cover arrangement* (i.e. credit rating or independent credit assessment)?

Q5: Do you agree with the introduction of a common good payment performance matrix in paragraph 4.7?

Q6: Do you agree with the proposed method of setting the User's Credit Allowance in paragraph 4.10?

Q7: What impact do you believe this change would have on the customer?

Q8: FOR DNO PARTIES: How many Suppliers use a good payment record as the only form of cover?

Q9: FOR SUPPLIER PARTIES: What impact do you believe this change would have on Suppliers entering the market?

Q10: FOR SUPPLIER PARTIES: What impact do you believe this change would have on existing Suppliers and what would be the costs to an existing Suppliers business if this change was to be introduced retrospectively?

Q11: Do you have any other comments on the proposed solutions for DCP 349?

Q12: Do you have any other solutions you would like the Working Group to consider?

5 Legal Text

5.1 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 be reduced from 60 months to 24 months after which time 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; 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

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recommended within the Independent Assessment and the value calculated by applying the Independent Assessment Score to the Transporter's Maximum Unsecured Credit Limit."

Q13: Do you have any comments on the proposed legal text?

6 Relevant Objectives

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

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Q14: 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. This could be used by Distribution Businesses to ascertain the likely level of risk involved in extending Supplier credit.

Q15: Are you aware of any wider industry developments that may impact upon or be impacted by this CP?

7 Implementation

8.1. We are keen to seek views on whether this change should be introduced retrospectively or not.

8.2. Parties will need sufficient time to prepare for implementation to cater for potential system or process changes. Consequently, implementation is proposed for the June 2020 Release.

Q16: What are your views regarding implementation of this change, should it be applied retrospectively or not? Please provide reasons.

Q17: 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 understand the intent of DCP 349?
2	Are you supportive of the principles of DCP 349?

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3	Do you agree with the proposal to reduce the number of months that unsecured cover can be built from 60 months to 24 months?
4	Do you agree that a six months transitional period for Suppliers to put in place their independently assessed secured cover arrangements?
5	Do you agree with the introduction of a common good payment performance matrix in paragraph 4.7?
6	Do you agree with the proposed method of setting the User's Credit Allowance in paragraph 4.10?
7	What impact do you believe this change would have on the customer?
8	FOR DNO PARTIES: How many Suppliers use a good payment record as the only form of cover:
9	FOR SUPPLIER PARTIES What impact do you believe this change would have on Suppliers entering the market?
10	FOR SUPPLIER PARTIES What impact do you believe this change would have on existing Suppliers and what would be the costs to an existing Suppliers business?
11	Do you have any other comments on the proposed solutions for DCP 349?
12	Do you have any other solutions you would like the Working Group to consider?
13	Do you have any comments on the proposed legal text?
14	Do you believe that the DCUSA General objectives are better facilitated by this CP. Please provide your rationale?
15	Are you aware of any wider industry developments that may impact upon or be impacted by this CP?
16	What are your views regarding implementation of this change, should it be applied retrospectively or not? Please provide reasons.
17	Do you agree with the proposed implementation date?
18	Do you have any other comments?

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8.2 Responses should be submitted using Attachment 3 to dcusa@electralink.co.uk no later than, 10 January 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
- Attachment 2 – DIF 57 'Effectiveness of the current provision of unsecured cover'
- Attachment 3 – Draft legal text
- Attachment 4 – DCP 349 Change Proposal

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