

Modification proposal:	Distribution Connection and Use of System Agreement (DCUSA) DCP349 – ‘Effectiveness of the current provision of unsecured cover under Schedule 1’ (DCP349)		
Decision:	The Authority ¹ directs that this modification be made ²		
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested parties		
Date of publication:	2 March 2022	Implementation date:	The first DCUSA release following Authority approval

Background

Under the current arrangements, supply businesses can obtain unsecured credit cover based on their good payment history. The maximum number of qualifying months of good payment history is 5 years (60 months). Once a supplier has built up 5 years of good payment history, it can use this cover indefinitely.

Following a supply business failure, outstanding charges are spread across all the other supply businesses, which may then be passed on to consumers through customer tariff charges. In recent years, there has been a significant increase in the number of supply business failures.

The modification proposal

Electricity North West Limited (ENWL) (‘the Proposer’) raised DCP349 on 10 June 2019. The intent of this change proposal is to mitigate the financial risk associated with supply

¹ References to the “Authority”, “Ofgem”, “we” and “our” are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

² This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

business failures by strengthening the criteria around the provision of unsecured cover and protect consumers from increased socialised failure costs.

The proposed solution is:

- The maximum number of qualifying months of good payment history remains 60 months, 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.
- For existing suppliers, there will be a minimum period of 12 months to transition to the new requirements.
- 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.

The Proposer considers that the solution will improve upon the current arrangements, as it is argued that a credit rating from either an approved credit referencing agency or an independent credit referencing agency to determine the Credit Allowance Factor (CAF)³ is a better indicator of financial stability than good payment history.

The Proposer considers that the solution will better facilitate Applicable DCUSA Objectives (c)⁴ and (d).⁵ This is because in strengthening and streamlining the obligations around the provision of the good payment performance element of cover, resulting in additional Independent Credit Assessments being carried out, the risk associated with Supplier business failures is reduced, together with the risk of increased socialised costs for customers. The Proposer considers that this change will better facilitate the efficient discharge of the DNO⁶ and IDNO⁷ Licence obligations and promote efficiency in the implementation and administration of the DCUSA.

On 17 March 2021, the initial Change Declaration was sent to us for decision. On 21 April 2021, we decided we could not form an opinion on whether or not DCP349 should be approved as we considered that there was insufficient analysis of the cost to suppliers

³ Credit Allowance Factor is defined in DCUSA Schedule 1, paragraph 2.3 [DCUSA Schedule 1](#)

⁴ Applicable DCUSA Objective (c) - 'The efficient discharge by the licensee of the obligations imposed upon it by this licence.' (condition 22.2(c) of [Electricity Distribution Consolidated Standard Licence](#)).

⁵ Applicable DCUSA Objective (d) - 'The promotion of efficiency in the implementation and administration of the DCUSA arrangements.' (condition 22.2(d) of [Electricity Distribution Consolidated Standard Licence](#)).

⁶ Distribution Network Operator.

⁷ Independent Distribution Network Operator.

and impact on retail competition, and insufficient analysis of the DNO financial impact due to supplier failure. Following our send-back decision,⁸ the working group reconvened to address our feedback. A revised Change Declaration was sent to us for decision on 14 December 2021.

DCUSA Parties' recommendation

In each party category where votes were cast (no votes were cast in the CVA Registrant party category),⁹ there was majority (>50%) support for the proposal and for its proposed implementation date. In accordance with the weighted vote procedure, the recommendation to the Authority is that DCP349 is accepted. The outcome of the weighted vote is set out in the table below:¹⁰

DCP349	WEIGHTED VOTING (%)							
	DNO ¹¹		IDNO/OTSO ¹²		SUPPLIER		CVA ¹³ REGISTRANT	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	79%	21%	100%	0%	67%	33%	n/a	n/a
IMPLEMENTATION DATE	100%	0%	100%	0%	67%	33%	n/a	n/a

Our decision

We have considered the issues raised by the proposal and the Change Declaration and Change Report dated 14 December 2021. We have considered and taken into account the vote of the DCUSA Parties on the proposal which is attached to the Change Declaration. We have concluded that:

- implementation of the modification proposal will overall better facilitate the achievement of the Applicable DCUSA objectives;¹⁴ and

⁸ [DCP 349 'Effectiveness of the current provision of unsecured cover under Schedule 1' | Ofgem](#)

⁹ There are currently no gas supplier parties.

¹⁰ The DCP349 Change Declaration voting end date was 10 December 2021.

¹¹ Distribution Network Operator.

¹² Independent Distribution Network Operator/Offshore Transmission System Operator

¹³ Central Volume Allocation.

¹⁴ The Applicable DCUSA Objectives are set out in Standard Licence Condition 22.2 of the Electricity Distribution Licence.

- directing that the modification is approved is consistent with our principal objective and statutory duties.¹⁵

Reasons for our decision

We consider this modification proposal will better facilitate DCUSA objectives (c) and (d) and has a neutral impact on the other applicable objectives.

Applicable DCUSA Objective (b)– the facilitation of effective competition in the generation and supply of electricity and (so far as is consistent with that) the promotion of such competition in the sale, distribution, and purchase of electricity

We agree with the Proposer and the majority of DCUSA Voting Parties that the implementation of DCP349 would have a neutral impact on this objective. Some respondents considered that this change would negatively impact DCUSA Objective (b). This section addresses these concerns and explains why we consider that the impact would be neutral.

Some respondents to the consultations commented that changes to the arrangements will affect retail market competition and disproportionately impact smaller suppliers and new entrants. This is because credit ratings may not be available to smaller suppliers in the same way as they are to larger, more established suppliers, and smaller suppliers may be less able to bear the costs of the alternative credit requirements. One DCUSA Voting Party also felt that this change would reduce competition in the supply of electricity.

Following our decision to 'send back' DCUSA Change Proposal 349, the Proposer obtained information on the criteria and costs involved in obtaining a credit assessment.¹⁶ Based on this additional information, we do not consider that there would be any material additional costs or barriers to suppliers in obtaining an independent credit assessment, or that these costs would be prohibitive to smaller suppliers. We also agree with the Proposer that this change would not impact new suppliers entering the market, as they would still be able to use good payment history as a form of cover for the first five years,

¹⁵ The Authority's statutory duties are wider than matters that the Parties must take into consideration and are detailed mainly in the Electricity Act 1989 as amended.

¹⁶ Details of this can be found within the DCP349 Change Declaration v2.0 [Effectiveness of the current provision of unsecured cover under Schedule 1 - DCUSA](#)

but after three years, the value of the cover starts to decrease, and they may need to utilise another form of cover.

Applicable DCUSA Objective (c) - the efficient discharge by the licensee of the obligations imposed upon it by its licence

We agree that the implementation of DCP349 will better facilitate the discharge by the licensee of the obligations imposed upon it by its licence. The Proposer considered that by strengthening the obligations around the provision of unsecured cover, the main financial risk imposed upon DNOs would be mitigated, which would increase the efficient discharge of the DNO and IDNO licence obligations.

The majority of respondents who commented on DCUSA objective (c) in the first consultation, and the majority of respondents to the second consultation agreed that this modification would have a positive impact on this DCUSA objective. The majority of DCUSA Voting Parties also agreed that this modification would have a positive impact on this DCUSA objective. One respondent said that the proposal will reduce the distributor's risk profile. Another noted that distributors hold licence obligations to ensure a financially secure network to protect the market and that enhancing the code credit arrangements in the DCUSA would better facilitate and achieve these requirements. We agree with both comments.

A Request for Information (RFI) issued to DNOs showed that, in the majority of cases where a supplier business had failed (between March 2018 and March 2020), the unsecured cover in place was good payment history. The RFI also showed that the total financial impact across 11 DNO Licence Areas based on supplier failures that were using good payment history as cover or a mix of good payment history and security was £9,019,334, which was a larger financial impact than the other forms of cover. This suggests that good payment history is not as reliable as other forms of cover, and that a secured cover arrangement or an acceptable, alternative, unsecured cover arrangement may be a better indicator of the financial stability of a supplier.

A minority of DCUSA Voting Parties commented that the solution does not seem to deal with the issue raised and has not fully assessed the risk of other forms of unsecured credit other than good payment history. We disagree with this view. We consider that the proposed solution should mitigate the financial risk associated with business failures and reduce DNO losses which would otherwise be claimed back from non-defaulting suppliers and ultimately consumers.

Applicable DCUSA Objective (d) – the promotion of efficiency in the implementation and administration of the DCUSA arrangements

We agree that the implementation of DCP349 will better facilitate the promotion of efficiency in the implementation and administration of the DCUSA arrangements. The Proposer considered that by strengthening the obligations around the provision of unsecured cover, the risk associated with supply business failures would reduce, together with the risk of increased socialised costs for customers being reduced. The Proposer considered that this would increase the promotion of efficiency in the implementation and administration of the DCUSA arrangements.

The majority of respondents who commented on DCUSA objective (d) in the first consultation, and the majority of respondents to the second consultation agreed that this modification would have a positive impact on this DCUSA objective. The majority of DCUSA Voting Parties also agreed that this modification would have a positive impact on this DCUSA objective.

One respondent to the second consultation commented that the impact on DCUSA Objective (d) would be neutral. They said that the proposed solution and the introduction of a common payment matrix may introduce additional elements to the administration of DCUSA, however having a consistent approach across all DNOs set out in the common payment matrix should bring clarity and consistency and reduce the likelihood of disputes.

We agree with the majority of respondents that the impact on this objective would be positive. We consider that, overall, the benefits that this respondent highlighted would promote the efficiency in the implementation and administration of DCUSA arrangements and outweigh any small, additional element to its administration.

Other respondents felt that the change would bring a positive impact and a majority of respondents were supportive of introducing a common payment matrix. We particularly agree with a comment that the clearer rules proposed for supplier credit using good payment history, the common payment matrix and the establishment of the requirement for secured/alternative unsecured cover after five years may improve the efficiency in administration of DCUSA.

Other considerations

We refer to our decision to approve Uniform Network Code (UNC) 305 'Unsecured Credit Limit allocated through Payment History'.¹⁷ This modification means that credit provision based on a UNC User's good payment history is only available as an option for new entrants for the first two years of operation. In approving this modification, we stated that "credit arrangements must strike an appropriate balance between properly managing risk and not making terms unduly restrictive ... We do not consider the requirement to obtain an independent credit assessment to be unduly onerous".¹⁸ We consider that this statement also applies to DCP349.

Decision notice

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority hereby directs that modification proposal DCP349: 'Effectiveness of the current provision of unsecured cover under Schedule 1' be made.

Barry Coughlan

Deputy Director, Retail Compliance

Signed on behalf of the Authority and authorised for that purpose

¹⁷ [Uniform Network Code \(UNC\) 305: Unsecured Credit Limit allocated through payment history \(UNC305\) | Ofgem](#)

¹⁸ [Uniform Network Code \(UNC\) 305: Unsecured Credit Limit allocated through payment history \(UNC305\) | Ofgem](#)