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SECAS Guidance Notes: Credit Cover under Section J3

Contents

Appendices

1. What this document will cover

Smart Energy Code (SEC) Parties are required to provide Credit Cover under Section J3 of the SEC. This document will tell you about what Credit Cover is, how it is calculated, and what you need to do as a SEC Party to ensure that your Party is compliant.

2. What is Credit Cover?

Credit Cover is an amount which a SEC Party provides to the Data Communications Company (DCC), to be used if it does not pay its DCC Charges.

2.1 Why is Credit Cover important?

Credit Cover is intended to avoid unpaid charges being socialised amongst other Parties. It is therefore important that all Parties adhere to the Credit Cover requirements under Section J of the SEC.

Credit Cover pays for a Party's outstanding debts up to the value of the Credit Cover in place. If a Party does not have Credit Cover and ceases to trade, unpaid DCC charges will be socialised amongst SEC Parties if they cannot be recovered through the administrators, which negatively impacts the industry.

If a Party does not provide the required Credit Cover, it will enter into Event of Default under the SEC (Section M8.1). This can negatively impact the Party as there are several actions that the SEC Panel can take to help resolve the default as quickly as possible. This includes notifying other SEC Parties that the Party is in default, suspension of several SEC rights, and the suspension of core communication services. For more information about Events of Default and the potential consequences, please click here. It is important that a Party complies with its Credit Cover obligation to avoid entering into default.

3. How is Credit Cover calculated?

SEC Section J3.2 provides the calculation used by the DCC to ascertain the level of Credit Cover a Party must have in place. The calculation considers the Party's Value at Risk and the Party's Unsecured Credit Limit.

3.1 What is the Credit Cover calculation?

The Credit Cover calculation is set out as follows:

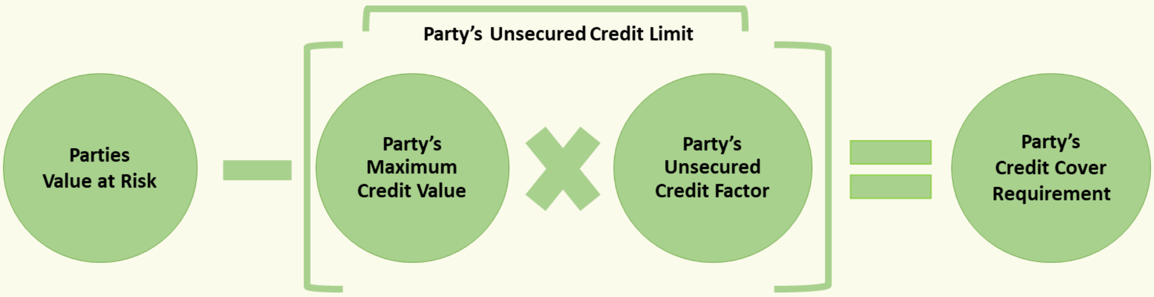

Figure 1: Credit Cover calculation

Party's Value at Risk (VAR)

This is the sum of any DCC Charges not yet paid by a Party, plus the Charges that the DCC estimates will be incurred by the Party until the next Invoice for that Party is due.

Party's Unsecured Credit Limit (UCL)

A Party's UCL is a Party's Maximum Credit Value multiplied by its Unsecured Credit Factor.

- **Maximum Credit Value (MCV)** – This value is the amount recommended by a credit assessment company such as Dun & Bradstreet, as the maximum amount a creditor should have outstanding to the Party at any one time.

  Each Party can choose one of the following valid credit assessment companies as set out in J3.8 of the SEC:

  - Dun & Bradstreet, Equifax, Experian Bronze Silver or Gold Report and Graydons Level 1, Level 2 or Level 3 Report.

- **Unsecured Credit Factor (UCF)** – This value is determined by the Party's Recognised Credit Rating or Credit Assessment Score. The tables in SEC Section J3.5 and SEC Section J3.8 determine a Party's UCF.

Should a Party use its Recognised Credit Rating or Credit Assessment Score to determine its UCF?

If a Party has a Recognised Credit Rating and a Credit Assessment Score, the Recognised Credit Rating will be used to determine the UCF.

A Party must meet the cost of a Credit Assessment Score at least every 12 months, provided its VAR exceeds the Credit Cover Threshold (£2,044). DCC use Dun & Bradstreet for all Credit Assessment Scores. Therefore, Parties will only need to meet the cost of a Credit Assessment Score if they wish to use a company other than Dun & Bradstreet.

When the UCF is set to zero

A Party's UCF will be set to zero if a Party:

- doesn't hold a valid Credit Assessment Score and/or Maximum Credit Value; or
- hasn't paid its DCC invoice by the due date on three or more occasions within a rolling 12- month period.

3.2 Who is not required to provide Credit Cover?

Parties who have a calculated Credit Cover Requirement less than £2,044 (the current Credit Cover Threshold) are not required to provide Credit Support to the DCC. This also means that these Parties won't need to meet the cost of obtaining a Credit Assessment Score until their VAR exceeds the Credit Cover Threshold (and even then, only if a Party chooses a company other than Dun & Bradstreet).

3.3 When can a Party use a Parent Company Guarantee?

A Party's obligations can be guaranteed by a Parent Company Guarantee (PCG) which can, in some cases, reduce a Party's Credit Cover Requirement (under Section J3.6 or J3.7).

Sections J3.6 and J3.7 provide that where a Parent Company has a Recognised Credit Rating or Credit Assessment Score, and the amount of the PCG is higher than the Party's

Value at Risk, the Parent Company's Credit Rating will be used to calculate the Party's Unsecured Credit Factor.

Where the PCG is capped at an amount LOWER than the Party's Value at Risk, the Party's Unsecured Credit Factor is adjusted to be the weighted average of the amount determined by using the Parent Company's Unsecured Credit Factor, and the Party's Unsecured Credit Factor.

To note: A PCG does not replace the need for Credit Cover, it merely adjusts the value required.

The DCC will accept a PCG from an Affiliate of the Party. The PCG must not have been breached or disclaimed by the guarantor and has at least one month left until it expires. If the company providing the PCG is incorporated outside of the United Kingdom, the guarantee will only be valid when it is supported by a legal opinion satisfactory to the DCC. If you have any questions regarding this, please contact the DCC Service Desk.

4. How Parties can ensure they are compliant

The DCC will contact a SEC Party if it is required to provide Credit Cover. If you are unsure about whether you have sufficient Credit Cover in place, please contact the DCC Service Desk.

4.1 How Parties can provide Credit Cover

SEC Parties can provide Credit Cover in three ways:

1. **Bank Guarantee –** this must be provided in a form reasonably acceptable to the DCC from a bank with the Required Bank Rating. The guarantee must not have been breached or disclaimed by the provider and must have at least one month left until it expires.

   To note: Required Bank Rating - a person with one or more long-term Recognised Credit Ratings of at least:

   "A-" by Standard & Poor's Financial Services LLC, "A3" by Moody's Investors Services Inc, "A-" by Fitch Ratings Limited and/or "A(low)" by DBRS Ratings Limited.

2. **Letter of Credit** - an unconditional and irrevocable standby letter of credit from a Bank using the form set out in Schedule 6 (see Appendix A). The bank must have the Required Bank Rating and the Letter of Credit must not have been breached or disclaimed by the provider.

3. **Cash Deposit** - a deposit of funds by, or on behalf of, the User into the DCC Credit Cover deposit account (also called the client account). The DCC can provide you with these details.

The Party can choose which method to provide Credit Cover, and it may use one or all three of the ways above to reach the amount required.

Please note: A Parent Company Guarantee does not qualify as a form of credit cover. To find out when a Parent Company Guarantee can be provided, please see section 3.3 above.

4.2 How Parties are notified that they are required to pay Credit Cover

If you are currently an active DCC User, the DCC will notify you if you are required to provide Credit Cover. The notification will be sent by email, from customerInvoices@smartdcc.co.uk.

If you are a newly acceded Party to the SEC, you will be asked to provide Credit Cover when you are completing the User Entry Process. Please contact the DCC Service Desk so they can advise what Credit Cover your Party requires.

4.2 Can a Party's Credit Cover requirement change?

The DCC calculates a Party's Credit Cover requirement at least once a week. A Party's Value at Risk will change dependent upon its usage of DCC services. A Party increasing its use of DCC services may experience a growing Value at Risk and may therefore be expected to pay a higher Value of Credit Cover.

If a Party is required to provide a higher level of Credit Cover, the DCC will notify the Party. A Party can expect this at any time in the month.

If a Party is providing too much Credit Cover, the DCC will contact the Party. It will ask if the Party wishes for the excess value to be repaid to the Party. If so, DCC will provide details for how the Party can request the refund. Currently, Parties must provide a PDF request on company headed paper, stating the value and company bank details. The DCC will then make this payment within five working days, per the SEC.

4.3 What happens when the DCC draws upon Credit Cover?

If a Party fails to pay its DCC Charges on time, the DCC will send a late payment notice. If the Party fails to pay within three working days of the notice, the DCC will draw upon a Party's Credit Cover. The DCC will notify the Party that it has done so.

The Party must then reinstate the required Credit Cover within two working days. If it fails to do so, the DCC will issue a late payment of Credit Cover notice. Should the Party fail to provide sufficient Credit Cover within three working days of this notice, the Party will then enter Default under SEC Section M8.1(d) and will be subject to several actions available to the SEC Panel.

5. Actions to prevent Credit Cover Event of Default

Your Party is recommended to undertake the following steps to ensure compliance with your obligations under the SEC:

1. Contact the DCC if you are unsure whether you have provided sufficient Credit Cover.
2. Set up a Direct Debit to pay your monthly DCC Charges. This will help ensure that your Party doesn't enter payment Default, which will avoid DCC drawing upon your Credit Cover.
3. Ensure that both SECAS and the DCC hold your most up to date contact details (we require both a primary and secondary contact). This will make sure that you are aware of any important Credit Cover or payment notifications.

Appendix A

SEC Schedule 6 – Form of Letter of Credit

Form of Document: Irrevocable Standby Letter of Credit

Documentary Credit Number: [ ]

Date of Issue: [ ]

Issuing Bank: [ ]

At the request of the Applicant, the Issuing Bank issues this irrevocable standby letter of credit ("**Standby Letter of Credit**") in the Beneficiary's favour on the following terms and conditions.

In this Standby Letter of Credit:

"**Applicant**" means [insert User's name]

"**Beneficiary**" means [DCC] [insert company number and address], and its successors as the DCC under the Smart Energy Code

"Beneficiary Statement" means a demand on the Beneficiary's letterhead, stating the name and title of the person signing on behalf of the Beneficiary, in the form set out at in the schedule to this Standby Letter of Credit.

"**Effective Date**" means [ ] (London, UK)

"**Expiry Date**" means [ ] (London, UK)

"**Maximum Amount**" means []

"**Smart Energy Code**" means the code of that name designated by the Secretary of State pursuant to the smart meter communication licences granted pursuant to the Electricity Act 1989 and the Gas Act 1986, as such code is modified from time to time.

1. From the Effective Date, this Standby Letter of Credit is available for payment at sight against presentation to the Issuing Bank of a Beneficiary Statement.
2. The Issuing Bank will not be obliged to make a payment under this Standby Letter of Credit if as a result the aggregate of all payments made by it under this Standby Letter of Credit would exceed the Maximum Amount.
3. The Beneficiary Statement must be presented to the Issuing Bank on or before the Expiry Date.
4. All payments under this Letter of Credit shall be made in Pounds Sterling in immediately available, freely transferable funds and for value on the due date to the account set out in the Beneficiary Statement.
5. The Issuing Bank hereby waives any right to set off or counterclaim whatsoever against any amounts payable under this Standby Letter of Credit in respect of any claims the Issuing Bank may have against the Beneficiary and such amounts shall be paid free and clear of all deductions or withholdings whatsoever. If the Issuing Bank is required by law to make a tax deduction from any amounts payable under this

Standby Letter of Credit, the amount due from the Issuing Bank shall be increased to an amount which (after such tax deduction) leaves an amount equal to the payment which would have been due if no tax deduction had been required.

6. This Standby Letter of Credit is personal to the Beneficiary, and the Beneficiary's rights hereunder (including the right to receive proceeds) are not assignable; provided that such rights shall endure for the benefit of the DCC's successors under the Smart Energy Code.
7. Except to the extent it is inconsistent with the express terms of this Standby Letter of Credit, this Standby Letter of Credit is subject to the Uniform Customs and Practice for Documentary Credits (2007 Revision), International Chamber of Commerce Publication No. 600 other than Article 38 thereof which is hereby waived and Article 36 is varied as below. Other than a person to whom this Standby Letter of Credit has been transferred in accordance with clause 6, this Standby Letter of Credit shall not confer any benefit on or be enforceable by any third party. If this Standby Letter of Credit expires during any interruption of business as described in Article 36 of said Publication 600, the Issuing Bank specifically agrees to honour any demand made under this Standby Letter of Credit within thirty (30) days after the resumption of business.
8. This Standby Letter of Credit and any non-contractual obligations or disputes arising out of or in connection with it shall be governed by and construed in accordance with the laws of England and the parties submit to the exclusive jurisdiction of the Courts of England for all disputes arising under, out of, or in relation to this Letter of Credit.

Signed for and on behalf of Issuing Bank

Form of Beneficiary Statement

We, the DCC under the Smart Energy Code (the "Beneficiary"), hereby state that we are entitled, in accordance with the Smart Energy Code, to demand ………..[insert amount being claimed] under Standby Letter of Credit number……..... issued by …………[insert name of Issuing Bank]. Payment in respect of this demand shall be effected immediately to [insert relevant account details]. We confirm that the signatory(ies) to this demand are empowered to sign and make this demand on behalf of the Beneficiary.

Appendix B

Worked examples of Credit Cover

Credit Cover Calculation (Section J):

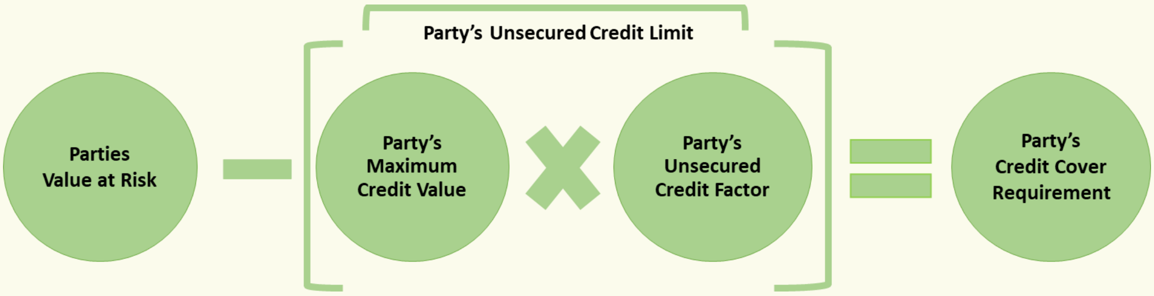

Figure 1: Credit Cover Calculation

Acronyms used in this document

To aid the explanation of calculations in this document, the acronyms used are set out in Table 1 below.

Acronym	What acronym stands for
VAR	Value at Risk
RCR	Recognised Credit Rating
CAS	Credit Assessment Score
UCF	Unsecured Credit Factor
MCV	Maximum Credit Value
Below E1	Credit Assessment Ratings from Dun and Bradstreet (Section J3.8)
5A1	Credit Assessment Ratings from Dun and Bradstreet (Section J3.8)

Table 1: Acronyms used in this document

Example 1: Where a Party has no unsecured credit factor

What SEC Party needs to work out	Example values
VAR	£100,000
RCR or CAS (of the Party)	Below E1
UCF (of the Party)	0%
MCV (from CAS) (of the Party)	£100,000
UCL (MCV x UCF)	£0.00

Credit Cover requirement = £100,000

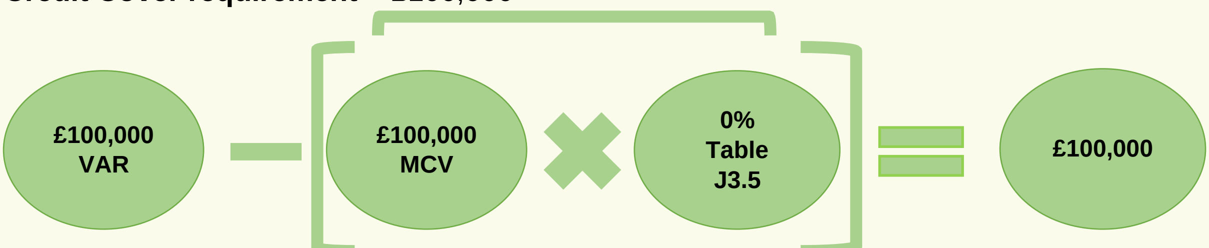

Figure 2: Credit Cover calculation where Party has no UCF

Example 2: The same as example 1, but where a Party uses an affiliate guarantee to provide the full VAR.

Where the affiliate guarantee is in place, the RCR or CAS (whichever is used), UCF and MCV are all that of the guarantor, not the Party.

What SEC Party needs to work out	Example values
VAR	£100,000
RCR or CAS (of the guarantor)	5A1
UCF (of the guarantor)	10% (as per table in J3.8)
MCV (of the guarantor)	£100,000
UCL (MCV x UCF)	£10,000 (£100,000 x 10%)

Credit Cover requirement = £90,000

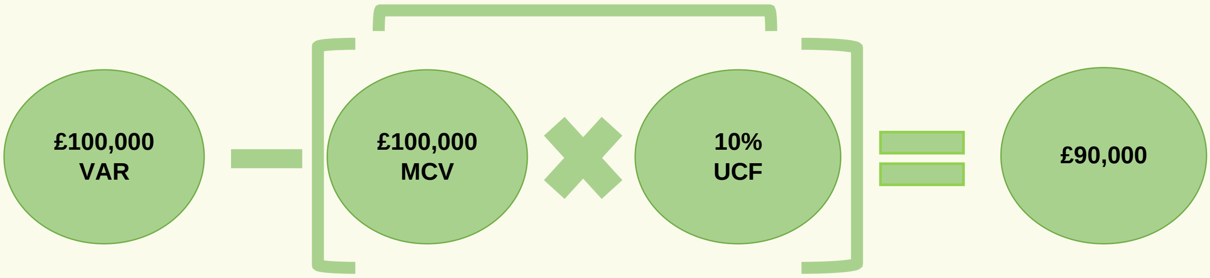

Figure 2: Credit Cover calculation where Party has an affiliate guarantee providing full VAR

Example 3: The same as example 2, but where an affiliate guarantee accounts for 50% of the VAR.

In this example, the RCR or CAS (whichever is used), UCF and MCV are calculated on a weighted average.

What SEC Party needs to work out	Example values
VAR	£100,000
RCR or CAS (of the Party)	Below E1
UCF (of the Party)	0% (as per table in J3.8)
MCV (of the Party)	£100,000
UCL (MCV x UCF)	£0 (£100,000 x 0%)
RCR or CAS (of the guarantor)	5A1
UCF (of the guarantor)	10% (as per table in J3.8)
MCV (of the guarantor)	£100,000
UCL (MCV x UCF)	10,000 (100 x 10%)
Weighted average UCF	£5,000 (£0 x 50% + £10,000 x 50%)

Credit Cover requirement = £95,000

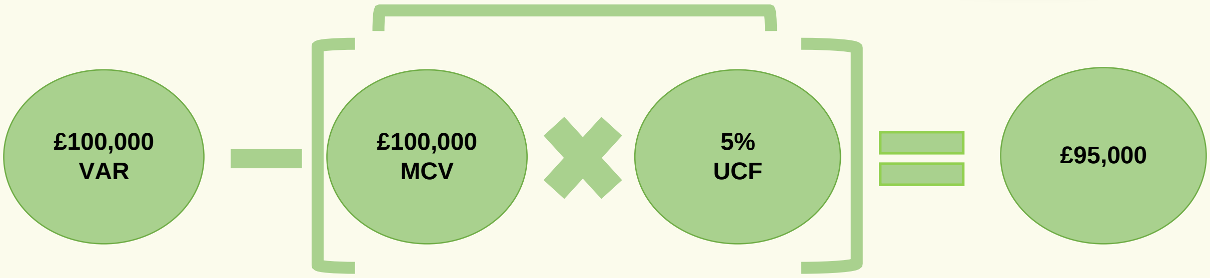

Figure 3: Credit Cover calculation where Party has an affiliate guarantee providing 50% VAR

Example 4: Where a Party has sufficient UCL to cover the full VAR

In this example, no Credit Cover is required

What SEC Party needs to work out	Example values
VAR	£100,000
RCR or CAS (of the Party)	5A1
UCF (of the Party)	10%
MCV (from CAS) (of the Party)	£3,000,000 (an example value)
UCL (MCV x UCF)	£300,000 (3,000,000 x 10%)

Credit Cover Requirement = £0.00

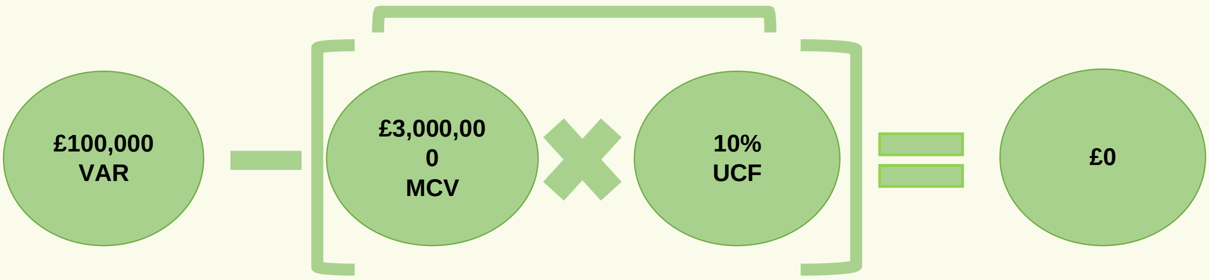

Figure 4: Credit Cover calculation where Party has sufficient UCF to cover the VAR