Smart Energy Code

SEC Smart Energy Code

Stage 02: Initial Modification Report

SECMP0016: Consideration of "Maximum Credit" value in credit cover calculation

This Modification Proposal seeks to make changes to the SEC Credit Cover Requirement calculation so that it takes into account the credit value specified by an independent credit assessor, which is similar to the approach taken for the UNC.

The recommendation is that this Modification should be:

- progressed as a Path 2: Authority Determined Modification

This Modification Proposal should:

- be progressed through the Refinement Process

High Impact:
Some SEC Parties might be required to deliver lower levels of credit cover to the DCC if this Modification Proposal was implemented.

What stage is this document in the process?

- 01 Modification Proposal
- 02 Initial Modification Report
- 03 Draft Modification Report
- 04 Final Modification Report

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SECMP0016
Initial Modification Report

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Gemserv

Administered by Gemserv
8 Fenchurch Place, London EC3M 4AJ

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About this document

This document is an Initial Modification Report. It has been issued to the SEC Panel to enable the Panel to carry out its initial consideration of the Modification Proposal on how the Modification Proposal should be progressed through the Modification Process.

Any questions?

Contact:
Sasha Townsend

secas@gemserv.com

020 7090 7755

Proposer:

Jeremy Guard

Jeremy.guard@first-utility.com

07800 912 665

Representative:

Carl Whitehouse

Carl.whitehouse@first-utility.com

07545 209 826

Administered by Gemserv
8 Fenchurch Place, London EC3M 4AJ

1. Summary of Modification Proposal

This section provides an overview of SECMP0016. For further details on the Modification Proposal, please refer to subsequent sections.

Defined terms and acronyms used in this document are listed in the Glossary (Section 9) of this document.

1.1 Why Change

The current Credit Cover Requirements outlined in SEC Section J3 'Credit Cover' does not take into account a "Maximum Credit" value that is specified by independent credit assessors.

1.2 Proposed Solution

The Modification Proposal seeks to make amendments to the SEC so that a "Maximum Credit" value is considered when calculating a SEC Parties Credit Cover Requirement. The Proposer has recommended that a similar approach is taken to the current credit arrangements specified in the Uniform Network Code (UNC).

1.3 Impacts

SEC Parties are subject to the SEC Credit Cover Requirements and will therefore be impacted. The Proposer has also noted that there will be higher impact for some SEC Parties, as the implementation of this modification could result in them delivering lower levels of credit cover to the DCC.

1.4 Targeted Implementation Date

The Proposer targets implementation in a release as soon as possible after DCC Live, and proposes the Modification Proposal is considered for implementation as part of the November 2017 Release (Release 3).

1.5 Release Management and Testing Requirements

This Modification falls under the Panel's Release Management Policy. Any necessary testing requirements will be informed during the Refinement process and form part of the Working Group considerations.

1.6 Proposed progression

This Modification Proposal must go through the Refinement Process pursuant to SEC Section D3.9 (c), as the modification may require changes to DCC Systems to implement any changes to how credit cover is calculated. Also as the solution requires further refinement as to how the modification would work in practice it also meets SEC Section D3.9 (d) as the change may not be insubstantial and is not a trivial change.

Section 6 of this document contains a detailed timetable and proposed/recommended Working Group constitution and objectives.

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2. Why Change?

2.1 What is the issue?

SEC Section J3 'Credit Cover' sets out that each SEC Party is obliged to provide the DCC with Credit Support in the form of a Bank Guarantee, a Letter of Credit and/or a Cash Deposit. The value of the Credit Support must be equal to or greater than the Party's Credit Cover Requirement, as calculated and communicated by the DCC. The diagram below summarises how a Party's Credit Cover Requirement is currently calculated.

Figure 1: Credit Cover Calculation

A Party's Value at Risk is the sum of any unpaid costs invoiced by the DCC and any costs that are likely to be incurred during the time period until the next invoice is produced. This value is then multiplied by the Party's Credit Cover Factor. This is a percentage determined by the Party's Recognised Credit Rating[1] or Credit Assessment Score[2]. The value resulting from the calculation will be the determined Party's Credit Cover Requirement.

The Modification Proposal notes that this existing calculation does not currently consider a "Maximum Credit" value which is also determined by an independent credit assessor (e.g. Dun and Bradstreet) when a Credit Assessment Score is reported.

The Proposer offers an example highlighting that new SEC entrants are often unable to achieve Recognised Credit Ratings due to them only trading for a short period of time. It was noted that this would mean the SEC Party would have a considerably higher Credit Cover Factor based on their Credit Assessment Score. This may then result in a SEC Party being required to provide a higher value of Credit Support, due to their calculated Credit Cover Requirement, than their assessed "Maximum Credit" value.

What's the issue?

The "Maximum Credit" value specified by independent credit assessors is not currently considered in the SEC Credit Cover Requirement calculation.

[1] As set out in the table in SEC Section J3.5
[2] As set out in the table in SEC Section J3.8

3. Proposed Solution

3.1 What's the solution?

The Modification Proposal seeks to add a provision to the SEC similar to the provision outlined in the UNC Credit Limit arrangements. The Proposer has highlighted the final paragraph in Uniform Network Code Transporation Principle Document (UNC TPD) Section 3.7[3] and recommends that a similar approach is taken in the SEC, to allow a "Maximum Credit" value to be considered when calculating a Party's Credit Cover Requirement.

The below diagram summarises the proposed amended to the Party's Credit Cover Requirement calculation.

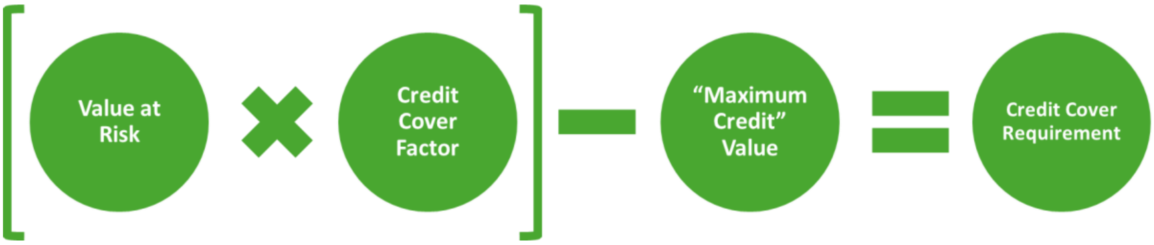

Figure 2: Proposed Credit Cover Calculation

An Example

The Proposer has provided an examples to demonstrate how the proposed change can affect a Party's Credit Cover Requirement and subseqent Credit Support if this Modification Proposal is approved. Figure 3 represents a ficticious Party's Credit Cover Requirement calculation as per the exisiting SEC Credit Cover provisions.

Figure 3: Example Credit Cover Requirement calculation

Based on the current SEC Credit Cover Requirement calculation the ficticious Party would be required to provide £600,000 as Credit Support. Figure 4 takes the existing

What's the solution?

The Modification Proposal seeks to make changes to the SEC so that a Party's "Maximum Credit" value is considered in the Credit Cover Requirement calculation.

[3] "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."

requirements and then shows what the Party's Credit Cover Requirement and subsequent Credit Support would be if "Maximum Credit" limit was included in the calculation, if this Modification Proposal was approved.

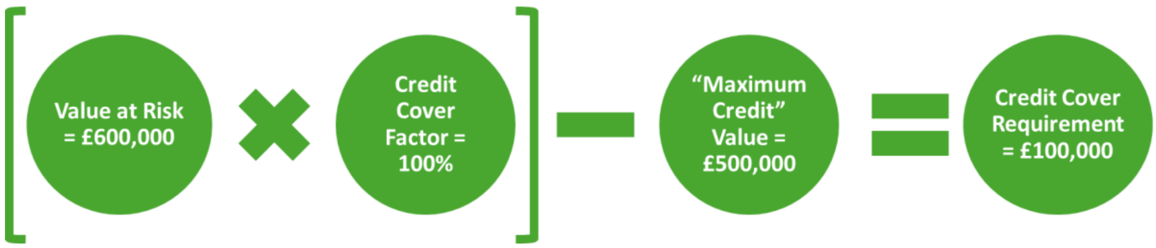

Figure 4: Example Proposed Credit Cover Requirement calculation

The Proposer highlights that the Party's Credit Cover Requirement and subsequent Credit Support would be therefore reduced if the Independent Assessors' "Maximum Credit" value was to be added.

It is worth noting that in the event of the proposed change to the calculation resulting in a negative Credit Cover Requirement value (due to the "Maximum Credit" value being higher than the Value at Risk multiplied by the Credit Cover Factor) then the SEC Party will not be required to provide any Credit Support.

3.2 Legal Text

Any necessary amendments to the SEC and relevant Subsidiary Documents will be prepared during the Refinement Process. However the Proposer has suggested that the amendment to the SEC could use a similar approach to the content of UNC TPD Section 3.7, particularly the text in bold below.

"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."

3.3 Applicable SEC Objectives

The below table presents the applicable SEC Objectives identified in the proposal and the Proposers view on how the proposed would better facilitate the achievement of these objectives.

How the Modification Proposal would better facilitate achievement of the SEC Objectives	
SEC Objective	Proposer views
(d) the fourth General SEC Objective is to facilitate effective competition between persons engaged in, or in Commercial Activities connected with, the Supply of Energy	The Proposer believes that the current Credit Support arrangements do not take into account the fact that some SEC Parties, especially new entrants, have only traded for a short period of time, and are therefore unable to achieve Recognised Credit Ratings or high Credit Assessment Scores. The Proposal feels that the current arrangement favours established SEC Parties and penalises SEC Parties that have recently entered the market. The Proposer suggests that this Modification Proposal will reduce the possibility of new entrants being required to place large sums of Credit Support with the DCC, which could distort competition and create a barrier to market entry and growth.

4. Impacts & Costs

The following section sets out the intial assessment of the likely impacts arrsing from SECMP0016. Additional impacts may be identified by the Working Group in the Refinement Phase.

4.1 Impacts

The following is provided as an indication of likely impacts as known at this time. The Refinement Process will further inform the effects of SECMP0016.

Material Impact on Greenhouse Gas Emission
The Proposer believes there will be no impact on Greenhouse Gas Emission.

Impact on Parts of Smart Energy Code or SEC Subsidiary Documents	
SEC Sections, Schedules of Appendices (Subsidiary Documents) likely impacted	Potential Impact
SEC Section A: Definitions and Interpretations	To capture any additional terminology that may need to be introduced as a result of the Modification Proposal
SEC Section J: Charges	The Modification Proposal seeks to make amendments to SEC Section J3 so that Parties' "Maximum Credit" value is considered when Credit Cover Requirements are being calculated.

Impact on other Codes and documents
No impacts on other Codes or documents have been identified.

Impact on Smart Energy Code Party Categories	
Party Category	Potential Impact
• Large Supplier Parties • Small Supplier Parties • Electricity Networks • Gas Networks • Other SEC Parties	The Proposer has identified that all SEC Parties could be impacted if this Modification Proposal is approved as they are all required to provide Credit Support to the DCC. The Modification Proposal highlights that if the change was to be approved, then the DCC would likely hold a lower amount of Credit Support for some SEC Parties than they would if the current arrangements remained. This may then impact SEC Parties if one of these Parties was to default.

Smart Energy Code

Are there any Impacts?

Yes. There will be impacts on SEC Parties.

Impact on Consumers
Whilst the Proposer expects there to be no direct impacts on Consumers, this will be considered further during the Refinement Process.

Impact on DCC Systems (subject to DCC assessment)	
Area of DCC impacted	Potential Impact
Data and Communication Company (DCC)	The Proposer has assumed that the Credit Cover Requirement is calculated manually for each SEC Party and therefore will be no DCC System impacts. However there is likely to be an impact on the DCC in that changes may be needed to incorporate "Maximum Credit" limit into the Credit Cover Requirement calculations if the Modification Proposal was approved. To be informed through the Refinement Process.
Data Service Provider (DSP)	The Proposer has not identified any potential impacts. To be informed through the Refinement Process.
Communications Service Providers (CSP)	The Proposer has not identified any potential impacts. To be informed through the Refinement Process.
Trusted Provider	The Proposer has not identified any potential impacts. To be informed through the Refinement Process.

Impact on other Systems	
Area of impact	Potential impact
User Systems	No impact.
Smart Metering Systems	No impact.
Other (e.g. Security and PKI)	No impact.

4.2 Costs

The costs of implementing SECMP0016 will be identified as it progresses through the Refinement Process. These costs will capture indicative DCC implementation costs as provided in their impact assessment responses and any SEC Party costs (where provided during the relevant consultations).

5. Implementation

The Proposer has requested that this Modification Proposal is implemented as soon as possible after DCC-Live. In recognising the need for certain processes and activities that must occur in accordance with SEC Section D, it is therefore proposed that this Modification Proposal is implemented as part of the November 2017 Release.

It was noted that it may become clearer during the Refinement Process whether this modification could be implemented earlier than the November 2017 Release may be achievable.

When will the modification be implemented?

The Proposer is seeking implementation in the November 2017 Release or sooner if possible.

5.1 Modification Testing Requirements

The Panel Release Management Policy notes that, as part of the Panel's considerations of a Modification Proposal and the associated implementation timetable and date, the Panel will consider what testing is required and who will be eligible to participate. SEC Section H14 requires the DCC to make provision for Modification Proposal implementation testing as part of its Testing Services.

The testing requirements under the Panel Release Management Policy are yet to be fully defined. It is anticipated that if this Modification Proposal requires testing it would be consistent with the SEC testing provisions. Any testing requirements will be informed during the Refinement Process, hence SECAS has added this aspect to the considerations of the Working Group (see section 6.6 below).

It is noted that the final testing scope and arrangements will be integrated under the Panel Release Management Policy approach for the relevant release.

6. Progression

6.1 Modification Path

Based on the initial review of the Modification Proposal and subsequent discussion with the Proposer, SECAS recommends that the appropriate Modification Path is: Path 2 - Authority Determined.

6.2 Progression route

The Refinement Process will be required for this modification to ensure the Modification Proposal is fully developed and that the impacts on the DCC are identified (pursuant to SEC Section D3.9).

The Refinement Process (SEC Section D6) requires that a Working Group is established by the Panel to undertake the Refinement Process. In outline, the objectives of the Working Group are to:

- Consider the effects of the Modification Proposal on participants, Emissions and Other Energy Codes;
- Evaluate, develop and refine the content of the Modification Proposal, including where the Working Group considers any Alternative Proposals may be relevant, prepare and submit this into the Refinement Process with the Proposers Modification Proposal;
- Evaluate, and amend if applicable, the proposed implementation timetable of the Modification Proposal including with regard to consistency with the Panel Release Management Policy;
- Obtain and take into account the views of other relevant Sub-Committees (Technical Sub-Committee (TSC), Security Sub-Committee (SSC), SMKI Policy Management Authority (SMKI PMA));
- Obtain assessments from the DCC as to the impact and costs;
- Consider the SEC Objectives that may be better achieved if the Modification Proposal was implemented;
- Conduct a Consultation(s);
- Consider any representations made to the WG by Parties; and
- Deliver a Modification Report to the Panel in respect of the Modification Proposal.

6.3 Working Group membership requirements

SEC Section D6.3 sets out that a Working Group must be at least 5 members with relevant expert knowledge. Therefore we propose that the Working Group should be made up of:

- The Proposer or a person nominated by the Proposer as a duly authorised representative of the Proposer;
- Working Group members:
    - who are broadly representative of the Users likely to be affected by the Modification Proposal, so that the Refinement Process is well informed in this case Suppliers and the DCC, although other interested Parties may come forward;
    - with relevant experience and expertise in relation to the subject matter of the Modification Proposal (TSC expertise need not be duplicated as this may be achieved through co-ordination between the WG and TSC);

- A Chair (see following section);
- A Secretary (provided by SECAS); and
- A Modification Analyst (provided by SECAS).

The Working Groups can also be attended by:

- DCC representatives;
- Ofgem representatives;
- DECC representatives; and
- Any interested members from Panel Sub-Committees such as the Technical Sub-Committee (or its Technical and Business Expert Community (TBEC)).

6.4 Convening the Working Group

It is noted that SEC Section D6.3 makes provision for the Panel, with the cooperation of the Parties to establish a standing list of persons with potentially relevant experience who may be willing to serve on Working Groups. While there are already four Working Groups in place, this Modification sits outside of the specific areas that they have been looking at.

Therefore it is recommended that an open invitation is issued at this time, with a view to using this exercise as a means of identifying the constitution of a new Working Group 5. SECAS recommends that Working Group Members with relative governance and credit experience are sought. This new Working Group 5 can then be used to cover similar modifications or other governance related changes that may get raised.

Modification Working Group members are required to meet the SEC requirements to confirm in writing to SECCo that they agree to serve on that Working Group and to do so in accordance with this Code.

6.5 Working Group Chair

SEC Section D6.4 enables the Panel to request that SECAS provides the Chair for the Working Group. While the Modification Process beds down, it is proposed that, to facilitate convening the Working Group in the first instance, SECAS provides the Chair. This is also in line with the outcomes of Ofgem's Code Governance Review (CGR) Phase 3: of which one outcome was that Working Groups should be chaired by the Code Administrator, unless there is a conflict of interest.

6.6 Working Group Terms of Reference

To meet the requirements of the Refinement Process set out in SEC Sections D6.8-D6.14 draft standard Terms of Reference are provided in Appendix B. The following questions have been identified for the Working Group to consider in order to fully assess the Modification Proposal.

Working Group Terms of Reference – supplementary matters to consider
What is the materiality of the issue?
Is the solution proposed in this SECMP0016 more efficient than the current arrangement?
Are there other deficiencies in the current solution that are addressed by SECMP0016?
What are the systems impacts for DCC?

Working Group Terms of Reference – supplementary matters to consider
What was the methodology and reasoning behind the current Credit Support arrangements?
What is the rough order of magnitude in terms of forecasted Credit Support?
What would be the impacts if a SEC Party, with a reduced Credit Cover Requirement as a result of this Modification Proposal, was to default?
What are the costs and lead times to introduce the solution in this SECMP0016?
Is the implementation timetable appropriate?
Are Consumers positively or negatively impacted by the Proposed solutions and to what extent?
What Modification Implementation Testing is required to implement the Proposed Modification, or any Alternative(s)?
What are the implementation steps and activities required to implement the Proposed (or an Alternative) Solution(s)?
Have the views of the relevant Panel Sub-Committee been taken into account?
Has the Refinement Process identified any potential reason that this Modification (or its Alternatives) may require EC Notification (noting that the Authority will determine if any such Notification is pursued)?

The above is not intended as an exhaustive list and it is expected that the Working Group will identify and address any other considerations that arise during the Refinement Process.

6.7 Timetable

As the Modifications Process has only recently been activated, the timetable set out below was put together in discussion with the Proposer and SECAS as a good faith estimate. A number of assumptions underpin this timetable:

- The Proposer has requested that the Modification Proposal is implemented as part of the November 2017 Release (or sooner if possible).
- The proposed timetable below has been built around a November 2017 implementation date, noting that the implementation date may need be flexible to accommodate the necessary implementation (and any testing) lead times, if the Modification Proposal is approved.
- The proposed timetable includes some assumed timescales for the turnaround of DCC's Impact Assessments and the Authority determination based on the indicative timescales provided by these entities.
- If the changes associated with this modification require EC Notification, the proposed timetable does not currently capture the three month 'stand-still' during EC notification. This is on the basis that any representations received during the stand-still need not necessarily result in any material change to the notifiable document or agreed solution in any way.
- The timetable has been drawn up based on this Modification Proposal progressing without cancellation or suspension under the *Smart Metering Implementation*

Programme Guidance on Secretary of State involvement with industry-led modifications to the Smart Energy Code during the transition to enduring governance[4] document issued by DECC.

- The timetable assumes that any Panel Sub-Committee inputs can be fed into the Refinement process at the appropriate time, and this may be subject to alteration.

Modification Timetable	
Activity	Date
Modification Proposal raised	3rd June 2016
IMR considered by Panel	17th June 2016
Working Group meetings Indicative activities: • Initial considerations • Legal drafting • Sub-Committee feedback • Alternative(s) identified • Impact Assessments • Detailed evaluation	June – October 2016
Working Group Consultation	November 2016
Final Working Group meeting Indicative Activities: • Consultation response summary • WG deliverables met • Assessment for Modification Report	November 2016
Panel reviews Modification Report	December 2016
Modification Report phase consultation	December 2016
Change Board vote	January 2017
Modification Decision by the Authority	January/February 2017
Implementation	November 2017

6.8 Grouping this Modification Proposal with others

There are a number of Modification Proposals that are currently entering the SEC process that have implications for a similar set of Parties and SEC Subsidiary Documents. It may

[4]Available at: https://smartenergycodecompany.co.uk/docs/default-source/modifications/decc-sec-modification-guidance-v1-0.pdf?sfvrsn=3

be possible to bring efficiencies into their Refinement under one Working Group. For example, whilst the underlying content may not be directly related, each solution may entail 'opening' similar provisions.

However as noted above SECAS considers that it would be appropriate to form a new Working Group 5 to refine SECMP0016, as the current Working Groups focus on technical matters only.

7. Panel Initial Assessment

The Panel is requested to **NOTE** the contents of this paper for SECMP0016 and, pursuant to SEC Section D3.6, **AGREE**:

- Whether to accept the Modification Proposal;
- That SECMP0016 is a Path 2 Modification (taking into account the view expressed by the Proposer);
- That it is necessary for the Modification Proposal to go through the Refinement Process as set out in Section 6.2;
- To establish a Working Group 5, with the membership and Working Group Chair as set out in Section 6.3;
- The supplementary considerations for SECMP0016 to supplement the standard Working Group terms of Reference set out in Section 6.6; and
- The Modification progression timetable set out in Section 6.7;

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8. Further Information

More Information is available in:

- Attachment **A**: Modification Proposal
- Attachment **B**: Standard Working Group Terms of Reference

For further information, please see the Modification Register page of the SEC website.

Or contact the SECAS at secas@gemserv.com.

9. Glossary

Glossary	
Term	Acronym
Data Communications Company	DCC
Smart Energy Code	SEC
Smart Energy Code Administrator and Secretariat	SECAS
Uniform Network Code	UNC
Uniform Network Code Transportation Principle Document	UNC TPD