Working Group Consultation Responses: SECMP0016 – Consideration of “maximum credit value” in credit cover calculation

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This document contains the detailed responses to the SECMP0016 Working Group Consultation. The Working Group reviewed these consultation responses and considered them as part of the solution development for this modification. The Working Group’s responses to each of the consultation responses is also detailed below.

A summary of the Working Group consultation responses and the Working Groups consideration of these responses is contained within section 7 of the SECMP0016 Modification Report.

If you would like any further information, or if you have any questions, please don’t hesitate to contact **Sasha Townsend** on **020 7191 1534**.

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Q1. Do you have any comments on the proposed solution?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Co-operative Energy	Small Supplier	Yes	The proposal provides a fair balance between the desired dual outcomes of 1) reducing supplier credit cover requirements and 2) protecting SEC Parties, and by association Consumers, from the risk of socialised bad debt by a defaulting party. It provides greater protection than relying simply on the Party's maximum credit value, while reducing parties' credit cover. It also retains a link to an external assessment of their credit risk.	The WG noted this response and did not have any further comments.
EDF Energy	Large Supplier	Yes	We believe the aim of reducing collateral outlay for SEC Parties is sensible given the aggregate impact of the various credit cover arrangements in the industry. We believe that an average credit cover of 31%, down from 72%, is reasonable and would not want the credit cover position any lower than that. In a rising, volatile market, smaller Parties are (arguably) at greater risk of default and that could lead to more losses smeared back to all remaining Parties. While we are supportive of the intent of the solution we believe that this is being achieved in an overly complex way and could be simpler. The solution refers to credit ratings (for example from Standard & Poor's) and also Credit Assessments/Scores from the likes of Dun & Bradstreet. Under other codes like the CUSC and DCUSA you can have one or the other counting towards an unsecured credit line. Unless we have misunderstood the proposal it appears that companies who have a credit rating will also have to ensure they have a credit assessment and, if they haven't, they need to pay to get one. We would disagree with that approach if that is the case - one or the other should be sufficient. The proposal amends the SEC to have three defined terms used in credit cover calculations which complicates the SEC content. It is	EDF Energy's observation that Parties with a Recognised Credit Rating will also need to obtain and meet the cost of a Credit Assessment, if SECMP0016 was to be approved, is correct. The WG acknowledged that this obligation on Parties differs from credit arrangements in other codes, such as the Uniform Network Code (UNC), Distribution Connection and Use of System Agreement (DCUSA), and Connection and Use of Systems Code (CUSC). However, it was highlighted that these codes determine User's unsecured credit limit as a proportion of the Network's Regulatory Asset Value (RAV), whereas the proposed solution is to determine a SEC Party's Unsecured Credit Limit as a proportion of their Maximum Credit Value. The DCC clarified that Recognised Credit Ratings (from issuers such as Standard & Poor's) do not include Maximum Credit Values. Therefore, it was deemed that there is not a solution to remove this proposed new obligation.

Q1. Do you have any comments on the proposed solution?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
			not clear why a different approach to that under the DCUSA and CUSC has been taken in that this proposes introducing two elements in determining one factor; this does not simplify and make industry arrangements more consistent, which should be the intent. Using ratings and scores is fine as that does help smaller suppliers who are typically scored but not rated but this is combining those factors in a way the other codes do not. We believe you could retain the definition of Credit Cover Factor within the legal text but include scores as qualifying for consideration in the CCF as well as ratings. We also think the 'cliff edge' approach for some of the rating tiers doesn't work (and that this doesn't work in DCUSA and CUSC either). For example, the difference in credit quality between a AA- and an A+ does not merit a difference between 50 and 20 in the factor; likewise, in the difference between 20 and 10 for A- to BBB+. There is a need to consider these factors in more detail to make the tiers more reflective of credit quality. We would propose an approach that looks at the underlying default rates that correspond to the credit ratings and also the credit scores. S&P, for example, publishes a table showing the historic default rates/probabilities for each credit rating and that could be a logical way to help set the Credit Cover Factors. We would be willing to put forward a specific, detailed, proposal if required.	A WG Member also highlighted that a Credit Assessment (from an assessor such as Dun & Bradstreet) costs approximately £8. The WG agreed that this is not considered to be a substantial cost for Parties to meet. The WG also discussed EDF Energy's comments in relation to additional complexities because of the proposed three new defined terms (Unsecured Credit Limit, Maximum Credit Value, and Unsecured Credit Factor). It was again noted that the consideration of a Party's Maximum Credit Value within the proposed solution means there has to be variations to the credit arrangement set out in the UNC, DCUSA, and CUSC. Whilst noting the proposed arrangements are more complex, the WG agreed that the defined terms were necessary to deliver the intent of the modification. The WG acknowledged the comments with regards to the 'cliff edge approach' to the proposed Unsecured Credit Factors based on Recognised Credit Ratings, but decided not to make any further adjustments. This is because the proposed factors had been aligned with the tiered approach recommended in Ofgem's "Best practice guidelines for gas and electricity network operator credit cover". It was therefore agreed that any further analysis of default rates corresponding with Recognised Credit Ratings could be considered

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Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
				across all industry codes in the future, but should not be considered within the scope of SECMP0016. The Proposer also noted that further adjustments to the Unsecured Credit Factors may cause some Party's Credit Cover Requirement to increase if this modification were to be implemented. The Proposer emphasised that this is not the intention of the Modification Proposal.
Electricity North West	Electricity Network	Yes	We see this as a positive change for all SEC Parties as it will in turn reduce the cost of providing cover in the way of bank guarantee or cash. However, the proposal does appear to favour 'lower rated' SEC Parties as Tables 3 and 4, detailing the proposed Unsecured Credit Factor %, are lower for lower rated SEC Parties.	The WG noted these responses and did not have any further comments.
First Utility	Small Supplier	Yes	First Utility as the proposer supports the modification and believe it will better facilitate SEC objective (d) related to competition through reduced credit cover requirements for parties that do not have one or more Recognised Credit Rating(s).	
Npower	Large Supplier	Yes	We believe this modification is applicable to the smaller independent SEC Parties (especially new entrants) who rely on credit assessment scores. This modification is attempting to bring the SEC in line with the UNC which we would support. It should be noted that whatever alignment to the UNC is made with regard to credit cover it must additionally ensure the any cover placed is sufficient for any parties' liabilities. The approval of this modification	The WG noted this response and considered two aspects with regards to the point around liabilities. Firstly, it was highlighted that a Party's liabilities, in accordance with SEC Section M2, are not currently covered under the SEC credit cover arrangements. Secondly, the WG noted that DCC Charges that Parties' are liable for, are being addressed by this Modification Proposal.

Q1. Do you have any comments on the proposed solution?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
			is in the interest of facilitating effective competition and removing barriers to market entry and growth.	
Opus Energy	Small Supplier	Yes	We support this modification as we believe it strikes a good balance between managing the risk of default and not forcing parties to lodge disproportionate levels of collateral.	The WG noted these responses and did not have any further comments.
Scottish and Southern Electricity Networks	Electricity Network	No		
Wales and West Utilities	Gas Network	Yes	The workgroup discussed in detail the original proposal and alternative options with regard to their impact on DCC and all SEC parties to ensure the solution was balanced. The solution removes a potential barrier to entry, minimises the risk of additional financial pressures being applied to a party by having to over securitise and does not significantly increase the risk to the wider community of socialised bad debt. The workgroup also reviewed other Industry codes and Ofgem's Best Practice Guidelines for gas and electricity network operator credit cover to ensure best practice was considered in the solution.	

Q2. Are there any alternative solutions that the Working Group have not yet considered?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Co-operative Energy	Small Supplier	No		The WG noted this response and did not have any further comments.
EDF Energy	Large Supplier	Yes	As noted in our response we agree with the intent and the outcome of the proposal, however we believe that it should be possible to enact those changes within the SEC in a way that is more straightforward than currently proposed.	The WG acknowledge the response provided and noted that this has been addressed by the WG's discussions on responses to question 1 of the Working Group Consultation.
Electricity North West	Electricity Network	No		The WG noted these responses and did not have any further comments.
First Utility	Small Supplier	No	We believe that the proposed solution provides an acceptable balance the between the amount of credit cover held by DCC and the level of increased risk. We also support the proposed solution because the amount parties pay is proportional to the level of risk each party introduces to the market, this is a fairer approach than many of the alternatives discussed by the working group and in our view reduces the distributional impact of the current credit cover calculation mechanism.	
Npower	Large Supplier	No		
Opus Energy	Small Supplier	No		
Scottish and Southern Electricity Networks	Electricity Network	No		

Q2. Are there any alternative solutions that the Working Group have not yet considered?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Wales and West Utilities	Gas Network	No	We believe all credible alternatives were considered and the workgroup report details these and the reasons for not progressing them.	The WG noted this response and did not have any further comments.

Q3. Do you agree that the proposed legal drafting delivers the intent of the proposed modification?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Co-operative Energy	Small Supplier	Yes	J3.3A contains a tautology. 'product of' and multiplied by. I suggest J3.3A reads: "Each Party's "Unsecured Credit Limit" is equal to:"	The WG agreed to amend the legal text, as suggested. This is reflected in the revised draft legal text in Attachment A of the Draft Modification Report.
EDF Energy	Large Supplier	Yes	We agree that the proposed legal drafting delivers the intent of the proposed modification. However, as noted previously, we believe it might be possible to achieve the same outcomes in a simpler way and with few new defined terms. We have identified a further change to the legal text that we would like to see made, but which may not be possible within the scope of this Modification Proposal. We believe that the obligation on a Party to provide additional credit cover within two working days is overly onerous. This timescale is insufficient to provide a letter of credit (which takes more like 10 working days) and even cash can be problematic in that timescale if signatories/authorisers are not in the office. We would like to see that timescale increased from 2 working days to 5 working days to be consistent with J3.11. We believe that a similar change will be proposed to the DCUSA.	The WG noted that EDF Energy's comment in relation to simplifying the solution have been addressed by discussions on question 1 of the Working Group Consultation. The WG also considered the further suggested change in relation to timescales for Parties to provide a Credit Support. It was agreed that this should not be included in the scope of SECMP0016 and should be raised as a separate Modification Proposal.
Electricity North West	Electricity Network	Yes		The WG noted these responses and did not have any further comments.
First Utility	Small Supplier	Yes	The legal drafting delivers the intent of the proposed modification in our view.	
Npower	Large Supplier	Yes		

Q3. Do you agree that the proposed legal drafting delivers the intent of the proposed modification?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Opus Energy	Small Supplier	Yes		The WG noted these responses and did not have any further comments.
Scottish and Southern Electricity Networks	Electricity Network	Yes		
Wales and West Utilities	Gas Network	Yes		

Q4. Do you agree that SECMP0016 should continue to follow Path 2 'Authority Determination'?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Co-operative Energy	Small Supplier	Yes	This will have a material impact on competition and parties so decision should reside with the BEIS.	The WG noted these responses and did not have any further comments.
EDF Energy	Large Supplier	Yes	We agree that SECMP0016 should continue to follow Path 2 'Authority Determination' as this Modification would have a material impact on competition.	
Electricity North West	Electricity Network	Yes		
First Utility	Small Supplier	Yes	We agree that SECMP0016 should follow path 2 to the Authority for approval. This is because whilst the modification has been designed so that no party has to place more credit cover with the DCC, it is clear that the amount of reduction in credit cover will vary between different types of SEC parties and therefore has a competition implication.	
Npower	Large Supplier	Yes		
Opus Energy	Small Supplier	Yes	We agree there is a material impact on competition.	
Scottish and Southern Electricity Networks	Electricity Network	Yes		
Wales and West Utilities	Gas Network	Yes		

Q5. Whilst noting that the reduced Credit Cover Requirement could reduce the probability of an Event of Default, do you agree that the risk of increased Unrecovered Bad Debt Payments for Parties in the Event of Default is acceptable?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Co-operative Energy	Small Supplier	Yes		The WG noted these responses and did not have any further comments.
EDF Energy	Large Supplier	Yes	We have no evidence to suggest that the risk of increased Unrecovered Bad Debt Payments for Parties in the Event of Default is not acceptable. The overall level of credit cover that is provided under the proposed arrangements would seem to be appropriate, and in line with that provided under other Codes.	
Electricity North West	Electricity Network	No	We are unable to confirm whether the risk of increased Unrecovered Bad Debt Payments for Parties in the Event of Default is acceptable due to no analysis being provided in the consultation.	The WG queried what analysis, in addition to the data model provided by the DCC, Electricity North West required to confirm whether the risk of increased Unrecovered Bad Debt Payments for Parties in the Event of Default is acceptable. SECAS raised this with the Party following the final WG meeting. Electricity North West had no further comments on this matter. They confirmed that they support SECMP0016, but feel they are not in a position to answer this question.
First Utility	Small Supplier	Yes	For supplier parties, we believe that the timeliness of the Supplier of Last Resort (SoLR) process are sufficiently short that the increased level of risk resulting from the modification is acceptable. We are not familiar with the equivalent “Last Resort” processes should other party types default, so cannot comment on them.	The WG noted this response and did not have any further comments.
Npower	Large Supplier	No	It is unlikely that the reduced Credit Cover Requirement could reduce the probability of an Event of Default, if a supplier is at risk of an Event of Default they should have enough cover to carry the bad debt, if not the risk is greater to remaining suppliers. We	The WG noted the responses provided by Npower. It was highlighted that this risk is subjective and generally applies to all businesses.

Q5. Whilst noting that the reduced Credit Cover Requirement could reduce the probability of an Event of Default, do you agree that the risk of increased Unrecovered Bad Debt Payments for Parties in the Event of Default is acceptable?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
			believe that consideration needs to be given to the fact that the associated reduced costs to a supplier means that they are better able to 'weather a financial storm', in which case it could be argued that there may be an increased risk in running parts of the industry on such close financial tolerances.	
Opus Energy	Small Supplier	Yes	The collateral required under the proposal is proportionate to an individual user's risk and in line with Ofgem's best practise guidance.	The WG noted these responses and did not have any further comments.
Scottish and Southern Electricity Networks	Electricity Network	Yes		
Wales and West Utilities	Gas Network	Yes		

Q6. Is your organisation impacted by this Modification Proposal?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Co-operative Energy	Small Supplier	Yes	This will reduce our credit cover, but also increase our risk of greater socialised bad debt risk.	The WG noted these responses and did not have any further comments.
EDF Energy	Large Supplier	Yes	We are impacted by this Modification Proposal. If this proposal were to be implemented, then we would require one months' lead time to implement these changes.	
Electricity North West	Electricity Network	Yes	We would be able to meet the modification proposal target date of 1st April 2017.	
First Utility	Small Supplier	Yes	First Utility would require a lead-time of 4 weeks.	
Npower	Large Supplier	Yes	As DCC is not able to hold bad debt, in the event of Default the remaining suppliers hold the increased risk and have to pay the bad debt and as such we feel that this may be the fundamental difference between the UNC and the SEC. We understand the principle of aligning the two codes, however, we think this fundamental difference may also need to be taken into account.	
Opus Energy	Small Supplier	Yes	We are likely to be required to lodge less collateral. There is no material lead time to implement.	
Scottish and Southern Electricity Networks	Electricity Network	N/A	Insufficient time to assess.	
Wales and West Utilities	Gas Network	No	The DCC charges to Gas Transporters & the charges are currently set at zero so WWU is currently not directly affected by this proposal. If in future our charges became non-zero WWU would have to provide security under the existing SEC terms. WWU	

Q6. Is your organisation impacted by this Modification Proposal?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
			therefore has an interest in this modification as there is no certainty regarding future values for GT charges.	

Q7. Do you agree with the potential impacts identified by the Working Group? For example, are there any impacts on Consumers?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Co-operative Energy	Small Supplier	No	Consumers are likely to benefit from increased competition and product offering in the energy retail market if the proposed modification is implemented. This is because new parties will have increased capital to invest in their business or reduce their prices.	The WG acknowledged that indirect positive and negative impacts on consumers, as result of this modification, could equally be identified. It was highlighted that SECMP0016 does not alter the risk of Unrecovered Bad Debt being socialised across Compliant Parties, as this is already the arrangement in the SEC. The WG believed that the modification does not increase the likelihood of default, and therefore does not negatively impact the consumer. A WG Member also commented that the Supplier of Last Resort (SoLR) process is in place to prevent negative impacts on consumers in an Event of Default. The WG therefore agreed that there are no direct impacts on consumers.
EDF Energy	Large Supplier	Yes	We agree with the potential impacts identified by the Working Group. In regards to the impact on customers we note that providing letters of credit costs money (paying annual fees to the issuing banks) and ties up credit lines. Using cash instead ties up liquidity; there is therefore ultimately a cost to customers when collateral increases as it increases a Supplier's cost base and they will pass that on to customers. Reducing the credit cover requirements therefore has the potential for savings that Suppliers are able to pass on to customers.	
Electricity North West	Electricity Network	Yes		
First Utility	Small Supplier	Yes	We agree with the potential impacts identified by the working group and agree that consumers are not directly affected.	
Npower	Large Supplier	Yes		
Opus Energy	Small Supplier	Yes		
Scottish and Southern Electricity Networks	Electricity Network	Yes		

Q7. Do you agree with the potential impacts identified by the Working Group? For example, are there any impacts on Consumers?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Wales and West Utilities	Gas Network	Yes		

Q8. Do you agree with the proposed implementation date?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Co-operative Energy	Small Supplier	Yes	This is the earliest, pragmatic date for implementation. The earlier the date, the earlier the benefits of the modification are felt. The April 2017 date allows for sufficient lead time for implementation and aligns with most parties' financial accounting year, reducing the complexity of implementation.	The WG noted these responses and did not have any further comments.
EDF Energy	Large Supplier	Yes	We agree with the proposed implementation date.	
Electricity North West	Electricity Network	Yes	We would be able to meet the modification proposal target date of 1st April 2017.	
First Utility	Small Supplier	Yes	We would like to see the modification implemented as soon as possible and welcome the timing proposed by the DCC and supported by the working group.	
Npower	Large Supplier	Yes		
Opus Energy	Small Supplier	Yes	It makes practical sense to implement at the start of the Regulatory Year	
Scottish and Southern Electricity Networks	Electricity Network	Yes		
Wales and West Utilities	Gas Network	Yes		

Q9. Do you have any additional benefits for the proposed solution?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Co-operative Energy	Small Supplier	No		The WG noted these responses and did not have any further comments.
EDF Energy	Large Supplier	No	We agree with the benefits identified for the proposed solution and have not identified any further benefits.	
Electricity North West	Electricity Network	No		
First Utility	Small Supplier	No		
Npower	Large Supplier	No		
Opus Energy	Small Supplier	No		
Scottish and Southern Electricity Networks	Electricity Network	No		
Wales and West Utilities	Gas Network	No		

Q10. Do you have any additional drawbacks for the proposed solution?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Co-operative Energy	Small Supplier	No		The WG noted these responses and did not have any further comments.
EDF Energy	Large Supplier	No	We have not identified any additional drawback for the proposed solution.	
Electricity North West	Electricity Network	No		
First Utility	Small Supplier	No		
Npower	Large Supplier	No		
Opus Energy	Small Supplier	No		
Scottish and Southern Electricity Networks	Electricity Network	No		
Wales and West Utilities	Gas Network	No		

Q11. Do you agree with the WG's views against the SEC Objectives?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
Co-operative Energy	Small Supplier	Yes	The proposed modification would reduce the working capital requirement for new and recent entrants to the domestic energy supply market. The proposed mod will increase their commercial viability and allow them to invest in building their business and contributing the vibrancy and consumer choice of energy suppliers.	The WG noted these responses and agreed with the views against the SEC Objectives.
EDF Energy	Large Supplier	Yes	We agree that this Modification Proposal would better facilitate objective (d) as it would remove a current barrier to entry for smaller Parties while at the same time reducing costs for all Parties. While this proposal does increase the level of residual risk overall, this is not disproportionately allocated to larger parties as a consequence of this proposal, the relative level of risk for each party remains roughly in the same proportion as now.	
Electricity North West	Electricity Network	Yes		
First Utility	Small Supplier	Yes		
Npower	Large Supplier	Yes		
Opus Energy	Small Supplier	Yes	We believe this modification is positive against objective d) as: • The more proportionate credit cover requirements will chiefly benefit parties that are unable to secure a recognised credit rating. These are likely to be newer entrants so this would reduce barriers to entry and allow these parties to compete more evenly.	

Q11. Do you agree with the WG's views against the SEC Objectives?				
Party Name	**Party Category**	**Response**		**Working Group (WG) Considerations and Response**
		Yes/No	Comments	
			• We agree with the workgroup and Ofgem's best practise guidelines that parties without a recognised credit rating are not always higher risk. The proposed mechanism more accurately ties a party's debt risk to their cover requirement and this increased fairness benefits competition.	
Scottish and Southern Electricity Networks	Electricity Network	Yes		
Wales and West Utilities	Gas Network	Yes		