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SEC Modification Proposal Form – SECMP0068

Mod Title

Alt HAN Company third party rights to enable external financing arrangements

Submission Date

6 December 2018

Details of Proposer

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1. What issue are you looking to address?

Background

Principle obligations within Standard Licence Condition (SLC) 55.2 of the Electricity Supply Licence and Standard Licence Condition 49.2 of the Gas Supply Licence require that all Relevant Supplier Parties, in conjunction with each other, must ensure that Alternative Home Area Network (Alt HAN) Activities are carried out and that Alt HAN Services are made available to all Relevant Suppliers.

Alt HAN Activities (as defined in SLC 55.6) involve arrangements for the financing of the costs incurred during the undertaking of Alt HAN Activities. Alt HAN Services (as defined in SLCs 55.7) include, but are not limited to, the manufacture, provision, installation, operation of Alt HAN Equipment. Under SLC 55.4 Alt HAN Services may be made available by entering into arrangements for the financing of the costs of the services.

In addition to the regulations above, The Department for Business, Energy and Industrial Strategy (BEIS) has confirmed the policy intent is to allow the Alt HAN Company (AlthANCo) to finance its costs.

SEC Section Z4 outlines the regulatory requirements pertaining to AlthANCo costs being reimbursed by the Data Communications Company (DCC). They outline the requirement for DCC to reimburse costs incurred by the DCC to AlthANCo and that the DCC is entitled to recover amounts paid by it to AlthANCo through DCC Charges, which are paid by Energy Suppliers.

What is the issue?

As preparations for, and as the Alt HAN Technology Solutions roll-out commences, high costs of technology solutions contracted via AlthANCo will be incurred over a short period. The pass-through of these costs in-year to Energy Suppliers will not be the most appropriate funding mechanism as Suppliers will be burdened with high upfront costs for Alt HAN, which will not necessarily reflect the level of benefit that current and future Suppliers will receive from Alt HAN solutions as market share changes over time.

Following direction from the Alt HAN Forum (Forum), (a Forum established pursuant to SEC Section Z and consisting of all Relevant Supplier Parties), AlthANCo is investigating possible financing routes to spread and reduce in-year costs for Energy Suppliers. Currently, the preferred financing model is an assignment of receivables model where AlthANCo would assign its right to receive income for the financed costs from the DCC directly to a funder. This loan agreement would be between AlthANCo and an external funder. Energy Suppliers would continue to pay the DCC via monthly invoices, with AlthANCo's receivables relating to the financed costs being assigned to an external funder. The external funder will provide payments to AlthANCo as required and will recover payments from DCC over time. Although other financing models are also possible, the assignment of receivables model is

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currently considered the most simple and cost-effective for the initial financing requirement. It is important to note that the need for AlthANCo to be given enforceable rights to receive payments from the DCC under the SEC would be required for all financing options.

The key issue for this financing arrangement is the ability to assign rights to receive income to the funder, to provide the necessary comfort that their revenue stream is secure. As AlthANCo is not a party to the SEC (as it has not signed the Framework Agreement or an Accession Agreement), technically it does not currently have an enforceable contractual right to receive payment of the AlthANCo costs from the DCC, and therefore by extension it cannot assign these rights. However, DCC are obligated to pay AlthANCo under its licence, under SEC Section Z4.7, or for Relevant Suppliers to pay under SEC Section Z4.11. It is not clear how AlthANCo would enforce its purported rights, since it is not a Party to the SEC and there is no reference to AlthANCo in the Third Party Rights clause (Section M11.5(b)), through which other Third Parties (ie: Comms Hub Lenders and SECCo) are permitted to enforce their rights.

As a result, it is not currently possible for funders to take an assignment of the right to the income received from the DCC, as they would have no ability to enforce that right. AlthANCo would be unable to pursue its preferred financing model as funders will not lend without a SEC Modification to give AlthANCo enforceable rights under the SEC and the ability to assign these rights. BEIS has also confirmed that the policy intent was for AlthANCo to be able to finance, but the current SEC drafting does not support this intent.

2. Why does this issue need to be addressed? (i.e. Why is doing nothing not an option?)

The current regulations represent a barrier to AlthANCo to enter into financing models. AlthANCo does not currently have a contractual right to receive payment of the AlthANCo costs from the DCC, or the ability to assign these rights. Without the ability to enforce its rights under the SEC, AlthANCo will be unable to pursue its preferred method of financing (an assignment of receivables model) as funders will not provide funds under this model without a Modification due to a lack of security over the revenue stream.

If financing is not secured, Suppliers will incur high in-year costs as a result of the AlthAN Programme which AlthANCo believes could hinder the Forum in meeting its objectives, such as to facilitate competition between persons engaged in, or in Commercial Activities connected with, the Supply of Energy.

3. What is your Proposed Solution?

AltHANCo has received legal advice and the proposed solution is to give AltHANCo Third Party Rights to enable it to enforce and assign its rights to receive payments from the DCC.

This is the preferred solution as it is less complex than other options considered, creates assignable and enforceable rights for AltHANCo against DCC and (with Ofgem consent) licensed suppliers, limits AltHANCo exposure to other SEC obligations and will not bind AltHANCo to the prohibition on assignment of rights (Section M11.8). It also represents a similar approach to that used elsewhere in the Smart Meter programme as the DCC has previously used this structure for its financing activities.

Alternatively, AltHANCo could obtain rights by acceding to the SEC. However, this is a more complicated, time consuming solution that would place additional obligations on AltHANCo.

Alt HAN Forum Decision

It has been agreed in principle by the Forum that AltHANCo should be given Third Party Rights to enable it to enforce its rights under Section Z4 and shall be entitled to assign the benefit of these rights. Through this action Forum has approved the work to pursue a SEC Modification to give AltHANCo rights under the SEC, but has not yet made a decision as to whether financing should be pursued for the initial stage of financing. This modification is an enabling change, which would allow AltHANCo the ability to pursue this financing approach which is expressed in the Energy Supply Licence and aligned to the policy intent.

This agreement has been documented in the Alt HAN Forum meeting (ALTHF_23_181128) minutes in the form of a Forum decision to pursue a SEC Modification to give AltHANCo the rights to be reimbursed by the DCC and also to be entitled to assign these rights.

Legal drafting

The proposed legal drafting below has been agreed by SEC lawyers. Draft legal text to give AltHANCo Third Party Rights to receive payments from the DCC and assign these rights is provided below:

Third Party Rights

M11.5 The following persons shall be entitled to enforce the following rights in accordance with the Contracts (Rights of Third Parties) Act 1999:

- (a) the person referred to in Sections C3.12 (Protections for Panel Members and Others) and M2.13(a) (Other Matters) shall be entitled to enforce the respective rights referred to in those Sections; ~~and~~
- (b) the Approved Finance Party for each Communications Hub Finance Facility shall be entitled to exercise and/or enforce the following rights of the DCC in respect of the Communications Hub Finance Charges relating to that facility where a Communications Hub Finance Acceleration Event has occurred in respect of that Communications Hub Finance Facility and the Authority has determined that the DCC is unwilling or unable to do so:
 - (i) the right to calculate the amount of the Communications Hub Finance Charges arising as a result of that event (provided in such circumstances that the Approved Finance Party must demonstrate to the satisfaction of the Authority that the amount of the charges so calculated will in aggregate be no more than the amount contractually due and payable (but unpaid) by the DCC to the Approved Finance Party in respect of that event);
 - (ii) the right to invoice the Users in respect of the Communications Hub Finance Charges arising as a result of the Communications Hub Finance Acceleration Event (whether in the amount calculated by the DCC in accordance with this Code, or in the amount calculated by the Approved Finance Party and approved by the Authority under Section M11.5(b)); and/or
 - (iii) the right to enforce payment by the Users in accordance with this Code of the amount of Communications Hub Finance Charges invoiced in accordance with this Code,

and the payment of any amount by a User to an Approved Finance Party pursuant to this Section M11.5(b) shall satisfy that User's obligation to pay that amount to the DCC; ~~and~~
- (c) AltHANCo (as defined in Section Z (Alt HAN Arrangements)) shall be entitled to enforce all rights which are conferred upon it under Section Z4 (Alt HAN Costs and Budgets), and shall (notwithstanding Section M11.8) be entitled to assign the benefit of these rights

Amend Section Z4.7 as follows:

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AltHAN Costs to be Reimbursed by the DCC

Z4.7 The Alt HAN Costs incurred by AltHANCo shall be reimbursed to AltHANCo by the DCC.
Nothing in Section M2 (Limitations of Liability) shall limit the DCC's liability to reimburse AltHANCo for the AltHANCo Costs.

This change to Z4.7 is consistent with M2.18 which applies to SECCo's recovery of Recoverable Costs.

4. What SEC objectives does this Modification better facilitate?

This Modification better facilitates General SEC Objective (d)¹ by spreading costs over a number of years preventing Suppliers having to pay high in-year costs for Alt HAN which would aid competition by helping to avoid cashflow issues for Suppliers.

This Modification also better facilitates General SEC Objective (h)² by:

- Enabling energy Suppliers to exercise their right under licence obligations with respect of 55.4(c) & 55.5(h) which are currently prohibited for an assignment of receivables mode:
 - 55.4(c)
 - entering into, by or on behalf of all Relevant Suppliers, of such arrangements for the financing of the costs of the services as are reasonably required for the purposes of ensuring the availability and provision of those services.
 - 55.5(h)
 - include such arrangements for the financing of the costs of any of the activities referred to in paragraphs (a) to (g) as are reasonably required for the purposes of ensuring the undertaking of, or acquiring of services which comprise or form part of, those activities; and

The Alt HAN Forum, which all Relevant Supplier Parties are entitled to attend, has agreed that an assignment of receivables financing model is an option it would like to consider.

¹ To facilitate effective competition between persons engaged in, or in Commercial Activities connected with, the Supply of Modification Energy.

² To facilitate the establishment and operation of the Alt HAN Arrangements.

5. What is the requested Path type?	Path 2
<ul style="list-style-type: none"> This modification meets the criteria under SEC Section D2.6(b)³ as this modification will have a material impact on Commercial Activities connected with the Supply of Energy. As AlthANCo are requesting that this Modification be treated as Urgent it will follow an Authority Determined path type. 	
6. Are you requesting that the Modification Proposal be treated as Urgent?	Yes
<p>This Modification should be treated as Urgent.</p> <p>This relates to Urgent Criteria (a)⁴ as set out in Ofgem's criteria under a "significant commercial impact on parties, consumers or other stakeholder(s)."</p> <p>AlthANCo is looking to initially finance development and mobilisation costs over the next financial year which would be spread over a number of years rather than being incurred in-year by Suppliers. From financial year 2020/21 AlthANCo will be looking to finance roll-out activities over a number of years. Financing will reduce in-year costs significantly for small and large Suppliers which AlthANCo considers has an advantage for competition as small Suppliers will face less cashflow issues.</p> <p>Without Urgent status, the Modification will not be implemented in time to allow AlthANCo to finance costs next year through an assignment of receivables model.</p> <p>The DCC has also given AlthANCo a deadline of 31st January 2019 to provide an updated view on the AlthANCo budget for financial year 2019/20. This approach has been approved as part of the budget consultation. A view as to whether financing is going ahead before this date is needed to prevent DCC from over-recovering in financial year 2019/20 from Suppliers.</p>	
7. What is your desired implementation date?	
<p>AlthANCo requires an ad hoc implementation date during the month of January to provide funders comfort over the regulatory regime and to allow AlthANCo to pursue an assignment of receivables financing model.</p>	

³ The variations are likely to have a material effect on competition in the Supply of Energy or Commercial Activities connected with the Supply of Energy.

⁴ A significant commercial impact on parties, consumers or other stakeholder(s).

The DCC has also given AlthANCo a deadline of 31st January 2019 to provide an updated view on the AlthANCo budget for financial year 2019/20. A view as to whether financing is going ahead before this date is needed to prevent DCC from over-recovering from Suppliers.

8. Which SEC Parties are expected to be impacted? (Please mark with an X)

Large Supplier Parties	X	Small Supplier Parties	X
Electricity Network Parties		Gas Network Parties	
Other SEC Parties	X		

Suppliers will be impacted as if the modification is approved they will incur less in-year costs in financial year 2019/20.

The DCC will also be impacted as its financial year 2019/20 budget will be revised downwards (subject to successful SEC Modification implementation). AlthANCo would also have the right to receive costs under Section Z4.

9. Which parts of the SEC will be impacted?

SEC Sections M11.5 and Z4.7 of the SEC will be impacted.

M11.5 will have a paragraph (c) added to state AlthANCo is entitled to enforce its rights under Sections Z4 (AlthAN Costs and Budgets) and shall be entitled to assign the benefit of these rights.

Z4.7 will be amended to state nothing in Section M2 (Limitations of Liability) shall limit the DCC's liability to reimburse AlthANCo for the AlthANCo Costs.



10. Will there be an impact on Central Systems? (Please mark with an X)			
DCC Systems	<input type="checkbox"/>	Party interfacing systems	<input type="checkbox"/>
Smart Metering Systems	<input type="checkbox"/>	Communication Hubs	<input type="checkbox"/>
Other systems	<input type="checkbox"/>		
There will be no impact on Central Systems.			
11. Will there be any testing required?			
There will be no testing required.			
12. Will this Modification impact other Energy Codes?		No	
There will be no impact on other Energy Codes.			
13. Will this Modification impact Greenhouse Gas Emissions?		No	
There will be no impact on Greenhouse Gas Emissions.			