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DP076 ‘Pursuing Non-Payment in Events of Default’

Problem statement – version 1.0

About this document

This document provides a summary of this Draft Proposal, including the issue or problem identified, the impacts this is having, and the context of this issue within the Smart Energy Code (SEC).

Proposer

This Draft Proposal has been raised by Simon Trivella from British Gas.

What is the issue or problem identified?

Background

The number of Events of Defaults handled by Smart Energy Code Administrator and Secretariat (SECAS) increased in the last financial year (2018/19). Most Events of Default are due to non-payment of Data Communications Company (DCC) Charges, and in many cases the company ceased trading; nine Parties exited the Smart Energy Code (SEC) in the last financial year. If a company ceases trading and has outstanding payments which cannot be paid by Credit Cover, costs will be socialised amongst SEC Parties.

One Event of Default saw a Party unable to pay its DCC Charges in November 2018. They admitted that payment would not be possible for the next four months and the Party went on to remain in an Event of Default for five months. Whilst payment was eventually recovered through the creation and commitment of a repayment plan, there was a tangible possibility that whilst outstanding payment was accruing, there was potential for a greater cost to be socialised amongst SEC Parties. Due to the wording of Section J2.6, the DCC were obliged to consult with the Panel over pursuing the non-payments in the Event of Default, but it did not require the DCC to follow the Panel's instructions on the course of action to be followed.

How does this issue relate to the SEC?

Section J2.6 of the SEC addresses payment default. It currently states that the DCC must notify the SEC Panel of a payment default, and that the DCC shall 'take all reasonable steps and proceedings to pursue payment'.

There is a general concern that the way that payment defaults are currently handled could affect the outcome of future defaults, and the SEC Panel propose to eliminate the possibility for SEC Parties to pay socialised costs as far as possible.

The DCC currently seek to pursue payment and consult with the SEC Panel, and the SEC Panel would like to address the ambiguity surrounding who has authority on the matter.

What is the impact this is having?

What are the impacts of doing nothing?

In practice the wording of Section J2.6 means that the DCC will keep the Panel updated on matters regarding pursuing non-payment as well as allowing the Panel to express their views, but ultimately the DCC must decide what it considers to be the best course of action (unless the Panel say it is no longer worthwhile to try and recover the costs). This approach puts the DCC at risk by deciding how to comply with the obligation, and in terms of justifying its approach for the purposes of the price control, which could increase the risk of increased costs to be socialised if action is not swift enough.

For the avoidance of doubt, if the DCC does not take all reasonable steps and proceedings to pursue and recover debts, the DCC will be in breach of the SEC and therefore in breach of its licence and at risk of Ofgem taking enforcement action. This may mean the DCC are unable to pass-through the bad debt under its price control. The Panel should notify Ofgem if the Panel considers that the DCC is in breach of Section J2.6 so that Ofgem can consider enforcement action, and so that Ofgem can decide whether to ultimately allow some, all or none of the bad debt under the DCC's price control.

What are the views of the industry?

Views of the DCC

The DCC provided some points for consideration under the issue raised by the Proposer, noting that these don't necessarily impact the SEC wording itself:

- How should the DCC receive its instructions to act in an Event of Default?
- How should the appeal mechanism would work? Would the organisation subject to the Event of Default appeal to Ofgem or the Panel and what would be the timescales involved?
- Should the DCC only act in an Event of Default once they receive instructions to undertake any reasonable steps?
- Should 'reasonable steps and proceedings' be defined?

These points were noted by the Change Sub-Committee who agreed that they would not have a direct impact on the SEC itself.

Views of SEC Parties

No comments were received from other Parties during the Development Stage.

Views of the Change Sub-Committee

The Change Sub-Committee discussed this proposal at their meeting on 28 May 2019 where they agreed that the issue is clearly defined and understood.

The DCC understood the intentions of the proposal and the types of issues it was trying to mitigate. However, they were concerned with the proposed solution as it was their view that a singular group made up of SEC Parties could unintentionally cause a conflict of interest by managing bilateral transactions between the DCC and SEC Parties. The DCC considered that the current arrangements were more suitable as it meant an impartial Party would manage such matters.

There was discussion regarding the process of pursuing non-payment, and whether larger Parties should be held responsible if smaller Parties cannot pay their debt. The Authority confirmed that price control methods are used to acquire the debt. They also noted the importance of Ofgem and the DCC ensuring that the process is suitable for each case. The Authority considered, and the Change Sub-Committee agreed that the proposal would benefit from the Refinement Process in order to give Parties the opportunity to provide comment and feedback on the solution.

Views of the SEC Panel

The Panel considered this proposal on 14 June 2019 where they agreed to covert this Draft Proposal into a Modification Proposal and for it to undergo the Refinement Process.

The Panel were in agreement that if the draft legal text for this proposal is significantly amended during the Refinement Process, then the Working Group should discuss where liability would sit if the DCC were to ignore the Panel's views when pursuing non-payment in Events of Default.