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MP076

‘Pursuing Non-Payment in Events of Default’

Modification Report

Version 0.1

About this document

This document is the Modification Report for [MP076 'Pursuing Non-Payment in Events of Default'](#). It provides detailed information on the background, issue, solution, costs, impacts and implementation approach. It also summarises the discussions that have been held and the conclusions reached with respect to this Modification Proposal.

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This document also has one annex:

- **Annex A** contains the redlined changes to the Smart Energy Code (SEC) required to deliver the proposed solution.

1. Summary

The wording of SEC Section J2.6 means that the Data Communications Company (DCC) will keep the Panel updated on matters regarding pursuing non-payment as well as allowing the Panel to express their views. Ultimately though, the DCC must decide what they consider 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 their 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.

The Proposer seeks to address this issue by amending Section J2.6(b) and obliging the DCC to follow any instructions given by the Panel in the pursuit of non-payment, rather than just consult with the Panel as under the current arrangements.

This modification will impact the DCC in pursuing non-payment in Events of Default. Ambiguity around the wording of Section J2.6 will be removed and the DCC will have to follow any instructions given by the Panel in the pursuit of non-payment. It is also envisaged that this modification will help limit the risk of increased socialised costs being incurred on SEC Parties by ensuring swift action is taken in such scenarios. Implementation costs will be limited to Smart Energy Code Administrator and Secretariat (SECAS) time and effort in updating the SEC and, if approved, this modification is targeted for the November 2019 SEC Release.

2. Background

What are Events of Default?

An Event of Default shall have occurred in respect of any Party other than the DCC, if one or more of the situations set out in SEC Section M8.1 (a) to (i) occurs in respect of the Defaulting Party. Events of Default can be categorised into financial (the most common), security and governance:

- A financial Event of Default could arise when a Party does not pay their DCC charges;
- An Event of Default concerning security could arise when a Party obtains Consumption data without the Appropriate Permissions; and
- An Event of Default concerning governance could arise when a Party is in material breach of any obligations under the SEC.

The number of Events of Defaults handled by SECAS increased in the last financial year (2018/19). Most Events of Default are due to non-payment of DCC Charges, and in many cases the company ceased trading; nine Parties exited the 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 their 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, with outstanding payment 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.

What is the issue?

SEC Section J2.6 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. The Panel seek 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 Panel over this. The Proposer would like to address the ambiguity surrounding who has authority on the matter.

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 they consider 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. There is also the increased risk that the DCC could ignore the Panel's advice in regard to pursuing non-payment.

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 their licence and at risk of the Authority taking enforcement action. This may mean the DCC are unable to pass-through the bad debt under their price control. The Panel should notify the Authority if they consider that the DCC is in breach of Section J2.6 so that the Authority can consider enforcement action, and so that the Authority can decide whether to ultimately allow some, all or none of the bad debt under the DCC's price control.

3. Solution

Proposed Solution

The Proposer seeks to amend Section J2.6(b) by obliging the DCC to show all reasonable steps and proceedings to gain agreement from the Panel, as well as consult with the Panel on matters regarding pursuing non-payment. The DCC could still choose not to take the Panel's advice but would have to show why they did so and that they took all reasonable steps to attempt to gain agreement from the Panel. This will provide clarity for the Panel as well as the DCC in how to manage such scenarios in future, as well as limit the risk of increased costs to be socialised amongst SEC Parties in Events of Default by ensuring action is taken swiftly enough to prevent this from happening.

Legal text

The changes to the SEC required to deliver the proposed solution can be found in Annex A.

4. Impacts

This section summarises the impacts that would arise from the implementation of this modification.

SEC Parties

SEC Party Categories impacted			
	Large Suppliers		Small Suppliers
	Electricity Network Operators		Gas Network Operators
	Other SEC Parties	✓	DCC

This modification will impact the DCC in pursuing non-payment in Events of Default. The ambiguity around the wording of Section J2.6 will be removed and the DCC will have to follow any instructions given by the Panel in the pursuit of non-payment.

No other Parties are expected to be impacted.

DCC System

This modification will not impact the DCC System.

SEC and subsidiary documents

The following parts of the SEC will be impacted:

- Section J 'Charges'

Other industry Codes

This modification will not impact any other industry Codes.

Greenhouse gas emissions

This modification will not impact greenhouse gas emissions.

5. Costs

DCC costs

There will be no DCC cost to implement this modification.

SECAS costs

The estimated SECAS implementation costs to implement this modification is two days of effort, amounting to approximately £1,200. The activities needed to be undertaken for this are:

- Updating the SEC and releasing the new version to the industry.

SEC Party costs

There is not expected to be any SEC Party costs as a result of this modification.

6. Implementation approach

Recommended implementation approach

SECAS are recommending an implementation date of:

- **7 November 2019** (November 2019 SEC Release) if a decision to approve is received on or before 24 October 2019; or
- **27 February 2020** (February 2020 Release) if a decision to approve is received after 24 October 2019 but on or before 12 February 2020.

The November 2019 SEC Release is the earliest SEC Release that this modification can be targeted for.

7. Discussions and development

How should the DCC pursue non-payment?

Comments from the DCC

During the Development Stage, the Proposer put forward proposed legal text to resolve the issue for consideration by the Change Sub-Committee, in order to inform the Panel should the subsequent Modification Proposal be progressed directly to the Report Phase. The DCC raised concerns with the proposed changes, which would have obligated them to follow the Panel's instructions. 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. It was noted that the DCC has an 'all reasonable steps' obligation within their License Conditions to collect the debt. If the DCC have not taken all reasonable steps, they could be liable for the debt through the price control mechanisms. This illustrates that although the SEC may benefit from further refinement on how to accomplish this in consultation with the Panel, the 'all reasonable steps' obligation remains constant in their license.

Another issue was highlighted that the Panel and the DCC are the two main parties involved in how these debt collection processes take place. Given these two parties work together, it would be pragmatic for them to agree the content of the modification. 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 and for this to be able to be accounted for.

The Panel subsequently issued the Modification Proposal to the Refinement Process and asked that if the draft legal text were to change, that it should be clarified where liability would sit if the DCC were to ignore the Panel in the pursuit of non-payment.

The Working Group did not have any comments on the draft legal text and the DCC were asked specifically for their views given they raised comments during the Development Stage. The DCC did not raise any comments or expand on their views.

The Proposer did not agree with the DCC's point that the proposed solution could cause a conflict of interest by giving the Panel more control in the process of pursuing non-payment, as Panel members are acting on behalf of the Panel independently of their organisations and have a duty to act on behalf of industry. It was also noted that an Authority representative sits on the Panel, further ensuring that the Panel act in the best interests of all SEC Parties.

Considerations from the Authority

It was highlighted, both by the SEC lawyers and the Authority, that the current wording of the SEC works in conjunction with the DCC Licence provisions concerning the recovery of bad debt. The provision in the licence requires the DCC to take 'all reasonable steps' to recover the debt, and if they are found not to have done so, the amount could be at risk to them during their annual price control.

It was highlighted by the Authority that the Proposer should ensure that the legal drafting for this modification does not contradict or impede the application of, or adherence to the licence by the DCC. If the drafting restricted what the DCC could practically do, insofar as only being able to follow the

Panel's instructions, there could be a potential conflict between the SEC and the DCC Licence provisions.

The Proposer suggested this could be done by retaining the 'in consultation with Panel' text but including 'Panel agreement' as well. In practice, this would retain the obligation for the DCC to consult with the Panel but add an additional requirement for the DCC to gain agreement from the Panel on the course of action to be taken. This would allow, when applicable, the Authority to determine whether 'all reasonable steps' had been taken by the DCC when the nature of the consultation, as well as seeking agreement from the Panel, is taken into account.

In addition, the Proposer also suggested that a further option could be to deem the DCC's obligation to follow the Panel's instruction as a minimum requirement. If, under the review of DCC's 'all reasonable steps', it is deemed that the DCC could have done more to prevent socialised costs, the DCC could fail under the SEC.

The Authority also noted, that they do not have a view on how the Proposer should ultimately draft the legal text, the important aspect to note is that the proposed text works in conjunction with the DCC licence provisions to deliver the desired outcome of the Proposer.

The SEC Lawyer's views

The SEC Lawyer examined these proposals and advised that the current obligation under Section J2.6 is deliberately worded to place the onus on the DCC to decide upon the most sensible course of action, as the DCC's ability to recover the bad debt via the price control will depend upon the Authority's assessment of whether the DCC acted sensibly. If the SEC constrains the DCC's options entirely, the DCC will always be able to recover the bad debt, and there will be no-one with a financial incentive to minimise bad debt. Taking this into consideration the SEC Lawyer queried whether the current SEC text should be changed at all. However, if it was to be changed, they proposed the following legal text amendments to Section J2.6(b):

- J2.6 Where the DCC has served a notice in accordance with Section J2.1 in respect of Charges payable by a Party, and such Charges have not been paid within three (3) Working Days following that notice, the DCC shall:*
- (a) as required by Section M8.2 (Notification of Events of Default), notify the Panel that an Event of Default has occurred in respect of that Party under Section M8.1(c); and*
 - (b) the DCC shall take all reasonable steps and proceedings (in consultation with the Panel) to pursue and recover the unpaid amount (together with interest); ~~unless and until the Panel (whether on the application of the DCC or otherwise) determines that it would not be worthwhile to do so in the circumstances; provided that the DCC shall where instructed to do so by the Panel~~ (having regard to, amongst other things, the DCC's duties under part D of Condition 11 of the DCC Licence) pursue a different course of action or stop pursuing the unpaid amount (but the Panel's ability to issue such instructions is without prejudice to the DCC's discretion concerning such steps and proceedings unless and until the Panel issues any such instructions and is without any obligation on the Panel to issue any such instruction).*

The Proposer did not believe the SEC Lawyer's proposed wording provided the clarity or delivered the intent the modification had been raised to do. The proposed wording was also deemed to not be in clear and plain English, creating the risk of misinterpretation amongst Parties. The Proposer therefore opted not to use the SEC Lawyer's proposed wording.

What did the Proposer conclude?

Taking into consideration the views received from the Authority and the SEC Lawyer, the Proposer made amendments to the original proposed legal text. The key change meant that rather than obligating the DCC to follow any instructions given by the Panel in pursuing non-payment, the DCC would have to take all reasonable steps and proceedings in consultation with and *in agreement with* the Panel. In effect the DCC must not only consult with the Panel, but also gain an agreement from the Panel. The DCC could still choose not to take the Panel's advice but would have to show why they did so and that they took all reasonable steps to attempt to gain agreement from the Panel. The legal text being taken forward can be found in Annex A.

Modification Path

The Authority noted the link between this modification and the DCC License and advised that some consideration needed to be given as to whether the modification should be Self-Governance or Authority Determined. Taking this into consideration, the Proposer recommends that this modification should be Authority Determined.

8. Conclusions

Benefits and drawbacks

The Proposer has identified the following benefits and drawbacks in implementing this modification:

Benefits

- The modification will ensure that the DCC have clarity over a direction to take with any cost recovery and that those steps have industry support (via Panel).
- This will also help to ensure that the risk of increased socialised costs is lessened for the DCC as they will have been acting in direct accordance with the Panel's direction.
- More generally, the proposed arrangements should bring greater rigour to the pursuit of non-payment process and therefore ensuring that bad debt is reduced, and Parties are protected from cash calls.

Drawbacks

The Proposer has not identified any drawbacks in implementing this modification.

Proposer's rationale against the General SEC Objectives

Objective (b)¹

The Proposer believes that MP076 may possibly better facilitate SEC Objective (b) as it could be argued that the implementation of this modification would support the First and Second General Objectives of the DCC. The First, from an economical and efficiency perspective, and the Second, from an effective competition perspective, would be facilitated by ensuring that Parties are not exposed to bad debt from competitors.

Objective (d)²

The Proposer believes that MP076 will better facilitate SEC Objective (d) by reducing the exposure of bad debt from Parties and ensuring that Users do not increase bad debt with the DCC, which will support more effective competition.

Objective (g)³

The Proposer believes that MP076 will better facilitate SEC Objective (g) as this modification would increase the robustness and rigour of the pursuit of non-payment process and, in turn, should lead to bad debt being minimised and the recovery of bad debt a more efficient process. This modification

¹ To enable the DCC to comply at all times with the General Objectives of the DCC (as defined in the DCC Licence), and to efficiently discharge the other obligations imposed upon it by the DCC Licence.

² To facilitate effective competition between persons engaged in, or in Commercial Activities connected with, the Supply of Energy.

³ To facilitate the efficient and transparent administration and implementation of this Code.

also increases transparency as the actions of the DCC in cost recovery will be clearer as they will be based on Panel direction.

Working Group members' views

The Working Group noted that the Proposer believed the modification benefited SEC Objectives (b), (d) and (g), as well as the benefits identified by the Proposer, and no objections to this were made.

Appendix 1: Glossary

This table lists all the acronyms used in this document and the full term they are an abbreviation for.

Glossary	
Acronym	Full term
DCC	Data Communications Company
SEC	Smart Energy Code
SECAS	Smart Energy Code Administrator and Secretariat



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MP076 ‘Pursuing Non-Payment in Events of Default’

Annex A

Legal text – version 0.2

About this document

This document contains the redlined changes to the SEC that would be required to deliver this Modification Proposal.

These changes have been drafted against SEC Version 6.16.

Section J 'Charges'

Amend Section J2.6 as follows:

J2 PAYMENT DEFAULT AND DISPUTES

Notification of Payment Failure

J2.1 Where a Party fails to pay an amount set out in an Invoice by the relevant Due Date, then the DCC shall, on the Working Day following the Due Date, issue a notice to that Party:

- (a) setting out the unpaid amount; and
- (b) referring to the matters set out in Sections J2.2, J2.4, J2.5, J3.16 (where applicable), and M8.1(c) (Events of Default).

Default Interest

J2.2 Where a Party fails to pay an amount set out in an Invoice by the relevant Due Date, then that Party shall pay interest on that amount at the Default Interest Rate calculated from day-to-day from the Due Date to (but excluding) the date on which payment is made (compounded monthly).

Notification of Payment Disputes

J2.3 Where a Party wishes to dispute any amount set out in an Invoice addressed to it, then that Party shall nevertheless pay the full amount set out in the Invoice by the Due Date, and shall give notice to the DCC of the disputed amount and the reason for the dispute. A Party may not give notice under this Section J2.3 (or otherwise dispute an amount set out in an Invoice) more than 12 months after the Due Date for that Invoice.

Resolution of Payment Disputes

J2.4 Where a Party disputes, in accordance with Section J2.3, any amount set out in an Invoice addressed to it, then:

- (a) such Party and the DCC shall each in good faith negotiate to resolve the dispute amicably and as soon as reasonably practicable after it arises;
- (b) the DCC shall provide all such evidence in support of its position as the disputing Party may reasonably request, and the DCC shall provide such evidence within 5 Working Days after such request;
- (c) no earlier than 1 Working Day after receipt from the DCC of the information requested under Section J2.4(b) (or, where the DCC does not comply with such request, on the expiry of the period referred to in that Section), the disputing Party may refer the dispute to the Panel, in which case each of the DCC and the disputing Party shall be entitled to provide written submissions in support of its position;
- (d) where a dispute is referred to the Panel in accordance with Section J2.4(c), the Panel shall convene a meeting and determine the dispute within 10 Working Days of the reference being made (to which meeting representatives of the disputing Party and the DCC may be invited in accordance with Section C (Governance)); and
- (e) where the Panel determines that there has been an overpayment to the DCC, the DCC shall include an adjustment in accordance with Section J1.9(c) to address such overpayment (or comply with any direction of the Panel to repay the relevant amount together with interest at the rate that would have applied had the adjustment been made in accordance with Section J1.9(c)).

J2.5 Section J2.4, and any determination by the Panel pursuant thereto, are without prejudice to the following rights of the Parties:

- (a) where the amount set out in an Invoice addressed to a Party is disputed on the grounds of whether or not the Charges were calculated and levied in accordance with the Charging Methodology and the Charging Statement, then either of that Party or the DCC may refer the matter to the Authority for determination pursuant to Condition 20 of the DCC Licence; or

- (b) where the amount set out in an Invoice addressed to a Party is disputed on any other grounds, then either of that Party or the DCC may refer the matter to arbitration in accordance with Section M7 (Dispute Resolution).

Pursuing Non-Payment

J2.6 Where the DCC has served a notice in accordance with Section J2.1 in respect of Charges payable by a Party, and such Charges have not been paid within three (3) Working Days following that notice, the DCC shall:

- (a) as required by Section M8.2 (Notification of Events of Default), notify the Panel that an Event of Default has occurred in respect of that Party under Section M8.1(c); and
- (b) the DCC shall take all reasonable steps and proceedings (in consultation with and in agreement with the Panel) to pursue and recover the unpaid amount (together with interest), and shall continue with such steps and proceedings unless and until the Panel (whether on the application of the DCC or otherwise) determines that it would not be worthwhile to do so in the circumstances (having regard to, amongst other things, the DCC's duties under part D of Condition 11 of the DCC Licence).

J2.7 Any Party may appeal the decision of the Panel under Section J2.6 to the Authority, and the DCC shall comply with any decision of the Authority in respect of such matter (which shall be final and binding, but without prejudice to the Panel's ability to make a further decision under Section J2.6 following a material change in circumstances).

Records

J2.8 Without prejudice to any other requirements under Laws or Directives, the DCC shall maintain records of each Invoice (together with reasonable supporting evidence for the Charges levied in the Invoice) for a period of at least 18 months following the date of the Invoice.