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MP086 'Alt Han Roll-Out Financing'

Modification Report Version 1.0

About this document

This document is the Modification Report for [MP086 'Alt HAN Roll-Out Financing'](#). 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

As preparations for, and as the Alternative Home Area Network (Alt HAN) Technology Solutions roll-out commences, high costs of technology solutions contracted via Alt HAN Co 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. This is because Suppliers will be burdened with high upfront costs for Alt HAN, which will not reflect the level of benefit that current and future Suppliers will receive from Alt HAN solutions as market share changes over time.

Currently the SEC does not facilitate the raising of long-term debt in the most economic and effective manner. As described in this Modification Report, two issues have been identified which prohibit and hinder Alt HAN Co's ability to secure financing for the Alt HAN roll-out.

The proposed solution is to amend the wording in SEC Section Z 'Alt HAN Arrangements' to allow Alt HAN Co to facilitate financing of the roll-out in a more economic and efficient manner.

This is an enabling change which will only impact Supplier Parties. This Modification Proposal has no impact on the Data Communications Company (DCC) Systems. The costs will be limited to Smart Energy Code Administrator and Secretariat (SECAS) time and effort in updating the SEC. This Modification Proposal will be targeted for the February 2020 SEC Release.

2. Background

What is the issue?

Earlier this year Alt HAN Co successfully secured financing for Alt HAN technology development and operational services mobilisation costs (the Design and Build (DAB) Phase Financing). Following direction from the Alt HAN Forum (a Forum established under SEC Section Z and consisting of all Relevant Supplier Parties), Alt HAN Co has investigated financing routes to spread and reduce in-year costs for Energy Suppliers for the roll-out of Alt HAN solutions. In August 2019 the Forum selected an assignment of receivables model to finance the roll-out. Under this model Alt HAN Co would assign its right to receive income for the financed costs from the DCC directly to a lender. The external lender will provide payments to Alt HAN Co as required and will recover payments from DCC over time. The assignment of receivables model was considered the most simple and cost-effective financing option.

However, currently the SEC does not facilitate the raising of long-term debt in the most economic and effective manner. There are two key issues that have been identified and need to be addressed which currently limit Alt HAN Co's ability to secure financing for the Alt HAN roll-out.

The first issue is that the SEC currently only makes provision for a single receivable, the payment of Alt HAN Costs by the DCC, that is legally payable by DCC to AltHANCo (the "DCC Receivable"). This has already been assigned to the existing lender under previous financing arrangements for the DAB Phase Financing.

However, the SEC does not distinguish between payment of the DAB Phase Financing Costs and the Roll-out Financing Costs. This means it is not possible to legally ringfence these two payment streams such that they can be financed independently of each other.

The second issue is concerned with Alt HAN Co's Budget approval. The Alt HAN Budget is crucial to Alt HAN Co's ability to raise finance. This is due to Alt HAN Co's ability to recover its financing costs from the DCC deriving from those costs provided in the Alt HAN Budget.

Alt HAN Co's budget is currently approved on an annual basis. This annual approval cycle has been raised by lenders as an issue when considering providing long-term financing due to a perceived budget approval risk. This perceived risk is likely to impact the terms Alt HAN Co is able to achieve during the roll-out financing and may even prevent financing from being secured.

What is the impact of doing nothing?

If the modification proposal is not approved Alt HAN Co will be unable to spread the cost of the roll-out of the Alt HAN Technology Solutions over a longer duration.

This modification proposal will enable changes, to allow Alt HAN Co the ability to pursue financing which is expressed in the Energy Supply Licence and aligned to policy intent behind SEC drafting.

If the proposal is not approved, Suppliers and consumers will incur high in-year costs as a result of the Alt HAN Programme. Alt HAN Co believes this 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.

MP086 was raised by Shell Energy on 17 September 2019 to resolve this issue.

3. Solution

Proposed Solution

The Proposed Solution is to amend entries in SEC Section Z 'Alt HAN Arrangements' to allow Alt HAN Co to investigate alternative methods for financing the Alt HAN rollout. Making these changes will allow Alt HAN Co to look at new models of funding the roll-out which could return lower costs to Supplier Parties in the short term. Alt HAN Co has stated that this re-modelling of the financing is critical to ensuring the roll-out is successful and that the short-term financial impact to industry participants is reduced.

The Proposed Solution will also codify in the SEC two different definitions of financing specific to Alt HAN. These two types of financing are described below:

1. DAB Phase Financing: This will cover any debt financing associated with the design assurance and build of the technical solutions used in Alt HAN equipment; and
2. Roll Out Phase Financing: This covers any debt financing entered into by Alt HAN Co for the purpose of supporting the Alt HAN roll out and any related ancillary services.

With regard to the first point, an amendment is required such that the existing assignment of the DCC Receivable in favour of the DAB financing lender is replaced with a new assignment over the newly created DCC Receivable in respect of just the DAB Phase Financing Costs. An independent assignment will also be given to the lenders to the Roll-out Financing of the DCC Receivable in respect of the Roll-out Financing Costs. This will allow legally ringfenced payment streams between the Roll-out Financing Costs and the DAB Phase Financing Costs. This is required as lenders will not take assignment over part of a receivable.

Without this modification Alt HAN Co will not be able to finance the Alt HAN roll-out, meaning Suppliers and consumers will be hit with high in-year Alt HAN costs.

With regard to the second point, the introduction of a long-term financing budget would hardwire the recovery of financing costs and eliminate budget approval risk (as perceived by a lender).

Under this solution the current Alt HAN Budget would remain as it is for operational expenditure, with long-term financing-only budgets only being introduced to cover the repayment period of the DAB and Roll-out financing arrangements (e.g. 10 years). This would include only the financing costs, throughout the tenor of the financing debt, so that those costs were approved to give lenders better certainty over the DCC Receivable, mitigating budget approval risk.

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

All Supplier Parties are impacted by this Modification Proposal. This modification is an enabling change, which would allow Alt HAN Co the ability to pursue financing for the Alt HAN roll-out which is expressed in the Energy Supply Licence and aligned to policy intent behind SEC drafting.

Financing will benefit Supplier Parties by preventing high in-year costs relating to Alt HAN Co.

DCC System

There are no impacts on DCC Systems.

SEC and subsidiary documents

The following parts of the SEC will be impacted:

- Section Z 'Alt HAN Arrangements'

Other industry Codes

There are no impacts on other codes.

Greenhouse gas emissions

There are no impacts on greenhouse gas emissions.

5. Costs

DCC costs

There are no DCC costs 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

No SEC Party costs are anticipated.

6. Implementation approach

Recommended implementation approach

Panel **agreed** an implementation date of:

- **27 February 2020** (February 2020 SEC Release) if a decision to approve is received on or before 20 December 2019.

The February 2020 SEC Release has been targeted as the ideal implementation date for this Modification Proposal. This is because with the Proposal being prepared to go straight to Report Phase in November 2019 and no lead time associated with the solution, it can be implemented in the February 2020 SEC Release.

7. Conclusions

Benefits and drawbacks

The Proposer, Alt HAN Co, the Change Sub-Committee (CSC) and Panel have identified the following benefits and drawbacks in implementing this modification:

Benefits

- This change will allow Suppliers paying for Alt HAN solutions to spread the costs over a longer period of time than currently. This will in turn lower the up-front cost that industry members will have to pay Alt HAN.

Drawbacks

- The Proposer has not identified any drawbacks in this Modification Proposal.

Proposer's rationale against the General SEC Objectives

Objective (h)¹

The Proposer believes that MP086 will better facilitate General SEC Objective (h) by ensuring the Alt HAN roll-out will be able to be financed effectively. They also believe it will assist in creating a suitable payment method to Supplier Parties using Alt HAN solutions.

Sub-Committee views

The all of Panel Sub-Committees were consulted on in the Development Stage, but they all confirmed that the Modification Proposal would not affect them.

The CSC when presented with the Draft Proposal for initial thoughts had no comment.

Panel's conclusions

The Panel agreed this should be a Self-Governance Modification and could proceed to Report Phase with no additional comments.

¹ Facilitate the establishment and operation of the Alt-HAN Arrangements.

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
Alt HAN	Alternative Home Area Network
Alt HAN Co	Alternative Home Area Network Company
CSC	Change Sub-Committee
DAB	Design and Build
DCC	Data Communications Company
SEC	Smart Energy Code
SECAS	Smart Energy Code Administrator and Secretariat



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