

To: All holders of a gas supply licence

**Gas Act 1986
Section 23(2)**

**Notice of statutory consultation on a proposal to modify the standard conditions
of all gas supply licences**

1. Each of the companies to whom this notice is addressed holds a gas supply licence granted or treated as granted under section 7A of the Gas Act 1986 ("the Act").
2. The Gas and Electricity Markets Authority ("the Authority")¹ gives notice that it proposes to modify the standard licence conditions (SLC) of all gas supply licences granted or treated as granted under section 6(1)(d) of the Act by introducing a new standard condition 4D in the manner set out in the schedule attached to this notice and described in the statutory consultation "Strengthening Financial Resilience" accompanying this notice.²
3. We are proposing these modifications because recent events in the energy market have exposed that some retail businesses had insufficient capital to manage the business of supply and pursued unsustainable strategies with low downside risk to investors. Some suppliers have been overly reliant on customer credit balances (CCBs) and Renewables Obligations (ROs) receipts for working capital and are generally insufficiently capitalised, despite strengthened guidance and regulations. These suppliers are more vulnerable to market shocks and therefore more likely to fail. These suppliers are more vulnerable to market shocks and therefore more likely to fail and exit the market due to insolvency. Where they do fail, that market exit results in Mutualised³ costs which are ultimately passed on to consumers.
4. We are proposing to introduce a new SLC 4D which will require the licensee to comply with the provisions of a direction made pursuant to SLC 4B.9 or 4B.10. Where a direction is made, the licensee must put in place arrangements, Credit Balance Support Arrangements, which are designed to cover the "Protected Amount" which is to be calculated in accordance with the methodology set out in paragraph 27 of the proposed modification using the Adjustment Percentage issued by the Authority and set out in the direction.
5. Where a licensee is directed under this condition, it will be required to calculate and notify to the Authority the Protected Amount for the Initial Period and each calendar month and provide the information set out in sub-paragraphs (a) -(f) of paragraph 27 of the proposed modification. This includes details of the source of funding to cover the Protected Amount.
6. The effects of this proposed modification, together with the proposed modifications to SLC 4B (the Financial Resilience Principle) and SLC 30 (Protecting the Renewables Obligation) is to both reduce the risk of supplier failure, and, where suppliers do fail, to reduce the mutualised costs associated with these failures. Further detail as to the effects of the proposed modifications of SLC 4B and SLC 30 has been published by the Authority on its website alongside this notice. The effect of this specific

¹ The terms "Authority", "we" and "us" are used interchangeably in this document.

² The accompanying consultation document can be found on the website.

³ As defined in SLC 1 of the gas supply licence

modification is to allow the Authority to issue specific requirements in relation to the amount of domestic customer credit balances which must be protected and the sources of funding which may be used to provide cover for the Protected Amount. The rolling requirement on the licensee to calculate and notify the Authority of the Protected Amount on a monthly basis will enable the Authority to ascertain whether the licensee has suitable protection in respect to its domestic customer credit balances.

7. A copy of the proposed modifications and other documents referred to in this Notice have been published on our website (www.ofgem.gov.uk). Alternatively, they are available from foi@ofgem.gov.uk.
8. Any representations with respect to the proposed licence modification/modifications must be made on or before 3 January 2023 to: Retail Financial Resilience team, Office of Gas and Electricity Markets, 10 South Colonnade, Canary Wharf, London, E14 4PU or by email to RetailFinancialResilience@ofgem.gov.uk.
9. We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so they can be placed easily on our website.
10. If we decide to make the proposed modification it will take effect not less than 56 days after the decision is published.

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Cathryn Scott
Regulatory Director – Enforcement and Emerging Issues
Duly authorised on behalf of the
Gas and Electricity Markets Authority
25th November 2022

Schedule 1 – Draft of proposed modifications to the standard conditions (SLCs) of all gas supply licences

We have included the SLC4D below and the changes we propose to make. Deletions are shown in strike through and new text is double underlined.

It is proposed that the drafting below will be placed after 4C (Ongoing fit and proper requirement)

SLC 4D Protecting Domestic Customer Credit Balances

Credit Balance Support Arrangements

4D.1 The licensee must comply with the provisions of this condition where the Authority has issued a direction pursuant to standard condition 4B.9 and 4B.10 setting out the Adjustment Percentage for the purposes of calculating the Protected Amount in accordance with the formula set out in paragraph 4D.4 of this condition.

4D.2 The licensee must put in place and thereafter maintain Credit Balance Support Arrangements that covers the Protected Amount in full for the duration of the Initial Period and thereafter each consecutive calendar month.

4D.3 The licensee's Credit Balance Support Arrangements must be notified to the Authority in the form provided for in the guidance on standard condition 4D ("the Consumer Credit Balance Guidance").

Calculating the Protected Amount

4D.4 The Protected Amount for the Initial Period and each subsequent calendar month (each being "the Relevant Period") shall be:

the Gross Credit Balance minus the Unbilled Consumption multiplied by the Adjustment Percentage.

4D.5 The Gross Credit Balance and the Unbilled Consumption are nominal values recorded by the licensee at the close of business the day after the date of the direction in respect of the Initial Period or the nominal values recorded by the licensee at the close of business on the last day of each consecutive calendar month.

4D.6 For each consecutive Relevant Period, the licensee must ensure that:

- i. its existing Credit Balance Support Arrangements cover the Protected Amount in full for the duration of each Relevant Period; or
- ii. if it has modified or supplemented its Credit Balance Support Arrangements, the modified or new arrangements cover the Protected Amount in full for the duration of the Relevant Period.

Process for calculating the Protected Amount

4D.7 Following a direction by the Authority, the licensee must calculate and notify to the Authority the Protected Amount for each Relevant Period in accordance with the provisions of paragraph 4D.4 of this condition. Day 1 of the Initial Period commences on the date specified in the direction. Day 1 of each subsequent Relevant Period commences on the first day of each calendar month.

4D.8 The licensee must:

(a) assess the sum total of funds to be protected for the duration of the Relevant Period;

(b) Submit the calculation of the funds to be protected including any information, data or analysis used to make the final calculation;

(c) Source and arrange one or more of the following Credit Balance Support Arrangements to cover the Protected Amount in full for the duration of the Relevant Period:

(i) Letter of Credit;

(ii) First Demand Guarantee;

(iii) An Escrow account; or

(iv) Cash deposited in a Credit Balance Trust Account

(d) submit written confirmation from a director with responsibility or oversight for the licensee's finances that the calculation of the Protected Amount made and notified to the Authority has been made in accordance with paragraph 4D.4 of this condition.

(e) evidence that the licensee's Credit Balance Support Arrangements cover the most recently calculated Protected Amount, including (where applicable) the most recent bank statement in relation to any Credit Balance Trust Account or Credit Balance Escrow Account and copies of its Credit Balance Support Arrangements;

(f) submit to the Authority the information set out in sub-paragraphs (a) to (e) above in the form provided for in the Consumer Credit Balance Guidance for each consecutive Relevant Period on or before Day 14 of the Relevant Period.

Guidance

4D.9 The licensee must comply with any Guidance (in addition to the 'Customer Credit Balance Guidance' referred to in condition 4D.3 issued and from time-to-time revised, following consultation, in respect of standard condition 4D).

Methodology and Definitions

4D.10 For the purpose of this condition:

"Acceptable Bank" A bank or other regulated financial institution situated in the United Kingdom that has an Acceptable Credit Rating.

"Acceptable Credit Rating" An Acceptable Credit Rating is an assessment by: Fitch Ratings as having a short term debt rating of "F1" or better.

Moody's as having—
a short term debt rating of "P-1", or
a long term debt rating of "A3" or better, or
Standard and Poor's as having a short term debt rating of
"A-1" or better.

**"Adjustment
Percentage"**
**"Credit Balance
Escrow Account"**

is the % the Authority directs in accordance with standard
condition 4B9 and 4B.10

A designated and segregated bank account maintained by
a third party escrow agent for the Designated Supplier in
the form provided for in Consumer Credit Balance
Guidance where:

a) the Escrow Account will be held in the name of the
escrow agent with a UK bank and the escrow agent is a
reputable, independent third party with experience of
operating escrow accounts;

b) in the event of licensee licence revocation the funds
would be payable to the Authority or the Authority's
nominee(s) (for example, the Supplier of Last Resort) on
demand;

c) the Protected Amount shall be payable to the Authority
or any nominee of the Authority on demand;

d) the Escrow Account arrangements must prohibit:
(i) any security being created by the licensee over the
Escrow Account; (ii) the Escrow Account being overdrawn;
(iii) withdrawals of the Protected Amount from the Escrow
Account (other than: (A) in excess of the then applicable
Protected Amount, (B) to refund to Fixed Direct Debit
Domestic Customers overpayments by such Fixed Direct
Debit Domestic Customers, or (C) in accordance with
directions by the Authority); and (iv) the crediting of funds
to the Escrow Account that are not Domestic Consumer
Credit Balances or interest accruing on the Escrow
Account.

**"Credit Balance
Support
Arrangements"**

One or more of the following:
Standby Letter of Credit;
First Demand Guarantee;
An Escrow account
Cash deposited in a Credit Balance Trust Account.

**"Credit Balance Trust
Account"**

A dedicated and segregated bank account in the name of
the licensee (i) with a bank branch in England or Wales,
(ii) over which the licensee has declared a trust complying
with the Credit Balance Trust Requirements.

**"Credit Balance Trust
Beneficiaries"**

Means both:
(i) the licensee and

- (ii) any Supplier(s) of Last Resort nominated from time to time by the Authority in relation to Fixed Direct Debit Domestic Customers of the licensee or, prior to the appointment of any such Supplier of Last Resort(s), the Fixed Direct Debit Domestic Customers of such licensee as a whole.

"Credit Balance Trust Requirements"

A trust in the form provided for in Consumer Credit Balance Guidance declared by a licensee in favour of the Credit Balance Trust Beneficiaries over a dedicated and segregated bank account of the licensee meeting the following requirements:

- a) the trust provides for the licensee to hold the entire benefit of the Credit Balance Trust Account, and all funds from time to time standing to the credit of the Credit Balance Trust Account, on trust for the Credit Balance Trust Beneficiaries as the only beneficiaries;
- b) the trust allows funds standing to the credit of the Credit Balance Trust Account in excess of the then applicable Protected Amount to be released from the Credit Balance Trust Account to a general operations account of the licensee;
- c) the Protected Amount shall be payable to the Authority or any nominee of the Authority on demand;
- d) the trust prohibits: (i) any security being created by the licensee over the Credit Balance Trust Account; (ii) the Credit Balance Trust Account being overdrawn; (iii) withdrawals of the Protected Amount from the Credit Balance Trust Account (other than: (A) in excess of the then applicable Protected Amount, (B) to refund to Fixed Direct Debit Domestic Customers overpayments by such Fixed Direct Debit Domestic Customers, or (C) in accordance with directions by the Authority); and (iv) the crediting of funds to the Credit Balance Trust Account that are not Domestic Consumer Credit Balances or interest accruing on the Credit Balance Trust Account; and
- e) notice of such trust has been given to the relevant account bank.

"Director"

Means a person legally responsible for running the company with knowledge and understanding of the licensee's finances.

"Domestic Customer Credit Balance"

Means, during any period, the aggregate amount by which payments to be made by Fixed Direct Debit Domestic Customers to the licensee under or in accordance with the relevant Domestic Supply Contracts exceeds the total amount of Charges which are to become payable by Fixed Direct Debit Domestic Customers to the licensee under

"First Demand Guarantee"

those Domestic Supply Contracts during such period minus any amount refunded to the Domestic Customer during that period.

Means an irrevocable, independent, primary and autonomous (in all circumstances) guarantee in the form provided for in Guidance provided (or confirmed) by a person established within the United Kingdom with a credit rating of at least BBB on issuance and maintained throughout the Liability Period, and that meets the following requirements:

- a) it does not contain any surety defence waivers or other drafting that is more characteristic of a suretyship guarantee than a primary and autonomous first demand instrument;
- b) it is issued in favour of the Authority as beneficiary, or in favour of any other beneficiary that the Authority shall nominate;
- c) it provides for drawing rights and their proceeds expressly to be freely assignable by the Authority or the Authority's nominee;
- d) it is available for drawing on demand for the full duration of the Liability Period;
- e) it provides for a compliant demand to state that, by reason of the insolvency of the licensee or revocation of the licensee's licence, the beneficiary is entitled to demand, and does demand, payment of an amount equal to, or less than, the Protected Amount prevailing on the date of the demand and provides a form of compliant demand in an annex to the guarantee;
- f) it provides for all demands to be full, final and conclusive proof for all purposes of the guarantee of their contents, including (without limitation) that the entity issuing such a guarantee may not dispute any demand on these matters;
- g) it permits partial and multiple demands that, in aggregate, total do not exceed the then-current Protected Amount;
- h) it provides for the Protected Amount to be available for drawing throughout the Liability Period and for that amount automatically to be topped up quarterly to the full amount required to be available for drawing under this Condition
- i) it provides for all payments under the guarantee to be made in full, on demand and without any deduction for or on account of any type of set-off or counterclaim; and
- j) it is expressly governed by UCP 600 (excluding article 32) or ISP 98, governed by English law, with an exclusive jurisdiction clause in favour of the English courts; and
- k) the guarantee has been executed and delivered as a deed by the guaranteeing party.

<u>Fixed Direct Debit</u>	<u>Means an instruction from the customer to their bank or building society that authorises an organisation to collect a fixed amount from the customer's account at regular intervals, provided that advance notice of the amount and the dates of collection have been provided.</u>
<u>"Gross Credit Balance"</u>	<u>means the aggregate of the licensee's Domestic Customer Credit Balances held in relation to Fixed Direct Debit Domestic Customers</u>
<u>"Initial Period"</u>	<u>means the 28 day period commencing on the date the direction is issued pursuant to standard condition 4B.9</u>
<u>"ISP 98"</u>	<u>means the International Chamber of Commerce's International Standby Practices (ICC Publication No 590)</u>
<u>"Liability Period"</u>	<u>a minimum period of 2 years</u>
<u>"Payment on Demand"</u>	<u>means immediate, unconditional and irrevocable payment of any amount demanded by the Authority which is equal to or less than the Protected Amount.</u>
<u>"Protected Amount"</u>	<u>means the Gross Credit Balance minus the Unbilled Consumption multiplied by the Adjustment Percentage</u>
<u>"Relevant Period"</u>	<u>means either the Initial Period or a calendar month</u>
<u>"Standby Letter of Credit" or "SBLC"</u>	<u>means an irrevocable, independent, primary and autonomous letter of credit in the form provided for in Guidance issued (or confirmed) by an Acceptable Bank in favour of the Authority or any other beneficiary that the Authority may nominate, that meets the following requirements:</u> <ol style="list-style-type: none"> a) <u>it contains express provision for the drawing rights and their proceeds under the SBLC to be freely assignable by the Authority or to any entity nominated by the Authority;</u> b) <u>the SBLC must either be available for drawing on demand for the full duration of the Liability Period or, during the full term of the Liability Period, the SBLC shall automatically renew annually for 365 days, but with the final renewal expiring at the end of Liability Period and an issuing bank (or confirming bank) may refuse to renew the SBLC on its expiry only if it gives written notice (a Cancellation Notice) to both the beneficiary and the Authority, such notice to be received by the beneficiary and the Authority not less than 120 calendar days before the date upon which the SBLC would otherwise renew;</u> c) <u>a demand must either state that, by reason of (i) insolvency of the Licensee or revocation of its Licence, or (ii) receipt by the beneficiary of a Cancellation Notice relating to the SBLC, the beneficiary is entitled to demand, and does demand, payment of an amount equal to, or less than, the Protected Amount prevailing on the date of the demand;</u> d) <u>All demands to be full, final and conclusive proof for all purposes of the SBLC of their contents,</u>

- including (without limitation) as to statements (i) or (ii) in the previous bullet point and neither the issuing bank nor any confirming bank may look behind any demand on these matters;
- e) A form of a compliant demand shall be annexed to the SBLC;
 - f) Partial and multiple demands permitted in aggregate total amount up to the maximum amount of the SBLC;
 - g) All payments under the SBLC shall be made in full, on demand and without any deduction for or on account of any type of set-off or counterclaim;
 - h) and
 - i) The SBLC is expressed to be governed by UCP 600 (excluding article 32) or ISP 98, governed by English law, with an exclusive jurisdiction clause in favour of the English or Scottish courts.

"UCP 600"

means the International Chamber of Commerce's Uniform Customs and Practice for Documentary Credits (2007 Revision)

"Unbilled Consumption"

Means the value of the energy by the licensee to likely be consumed by all Fixed Direct Debit Domestic Customers and calculated in accordance with the terms of the relevant Domestic Supply Contracts, but not yet included in a Bill or deducted from that Fixed Direct Debit Domestic Customer's Domestic Customer Credit Balance.