

**To: All holders of an electricity supply licence**

**Electricity Act 1989  
Section 11A(2)**

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

1. Each of the companies to whom this notice is addressed holds an electricity supply licence granted or treated as granted under section 6(1)(d) of the Electricity Act 1989 (“the Act”).
2. The Gas and Electricity Markets Authority (“the Authority”)<sup>1</sup> gives notice that it proposes to modify the standard conditions of all electricity supply licences granted or treated as granted under section 6(1)(d) of the Act by amending Standard Licence Condition (SLC) 4B in the manner set out in the schedule attached to this notice and described in the statutory consultation “Strengthening Financial Resilience” accompanying this notice.<sup>2</sup>
3. We are proposing modifications to SLC 4B (alongside related licence modifications which introduce a new SLC 4D (Protecting Domestic Customer Credit Balances) and SLC 30 (Protecting the Renewables Obligation)) 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 retail businesses have been overly reliant on customer credit balances (CCBs) and Renewables Obligations (RO) 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 and exit the market due to insolvency. Where they do fail, the market exit results in Mutualised<sup>3</sup> costs which are ultimately passed on to consumers.
4. Further detail as to why the Authority proposes to make these licence modifications has been published by the Authority in the following accompanying document:  
<https://www.ofgem.gov.uk/publications/statutory-consultation-strengthening-financial-resilience>.
5. The proposed modifications introduce:
  - a. a range of requirements relating to supplier capital adequacy and financial arrangements including a minimum capital requirement in 2025;
  - b. notification requirements regarding payments, provision of loans and asset transfer where the supplier does not hold the minimum capital requirement;
  - c. monitoring and reporting requirements; and
  - d. the power to direct the protection of domestic customer credit balances in circumstances where suppliers do not meet the capital adequacy / financial arrangements standards or where there is a material risk that they will not meet these in the next 12-month period.

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

2 The accompanying consultation can be found on our website.

3 As defined in SLC 1 of the electricity supply licence.

6. The proposed modifications also remove the current SLC 4B.2 because this requires suppliers to have adequate financial arrangements in place to meet its costs at risk of being Mutualised. The new proposed SLC 4B.1 requires suppliers to ensure that their financial arrangements are such that they are able to meet reasonably anticipated financial liabilities as they fall due. We consider that this includes a requirement to have adequate financial arrangements in place to meet costs at risk of being Mutualised. Therefore, we have proposed removing SLC 4B.2 to avoid unnecessary repetition.
7. The effect of the proposed modifications is to improve supplier financial resilience by: transforming supplier business models such that they are increasingly well-capitalised; increasing visibility of financial distress at an individual supplier level, enabling swifter and more targeted intervention by the Authority where required; and (through the power to direct) minimising the amount of Customer Credit Balances that require to be honoured by a Supplier of Last Resort or form part of the expenses of a Special Administrator where a supplier fails (and which are thereafter passed on to other market participants and ultimately consumers through cost mutualisation). Improved supplier financial resilience and the possibility of earlier, targeted intervention by the Authority will reduce the level of supplier failures and therefore the risk of Mutualised costs that would be caused if these failures arise.
8. The power to direct the protection of Customer Credit Balances (and the related requirements to protect the Renewables Obligation), will minimise the Mutualised costs where a supplier does fail. This is because certain elements of the costs at risk of mutualisation (CCBs and RO) can be protected in a manner that is designed to survive supplier insolvency such that not all of the outstanding CCBs and RO would require to be Mutualised. Further detail as to the effects of the proposed modifications of SLC 30 and SLC4D has been published by the Authority in the accompanying Notices for SLC 30 and SLC 4D and are available on the website.
9. A copy of the proposed modification and other documents referred to in this Notice have been published on our website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)). Alternatively, they are available from [foi@ofgem.gov.uk](mailto:foi@ofgem.gov.uk).
10. Any representations with respect to the proposed licence 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](mailto:RetailFinancialResilience@ofgem.gov.uk).
11. 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.
12. 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**  
**Duly authorised on behalf of the**

**Gas and Electricity Markets Authority**  
**25<sup>th</sup> November 2022**

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

We have included the SLC4B below and the changes we propose to make. Deletions are shown in strike through and new text is double underlined.

Condition 4B. Financial responsibility principle

4B.1 The licensee must ensure that it maintains Capital and Liquidity of sufficient amount and Quality that it is able to meet its reasonably anticipated financial liabilities as they fall due on an ongoing basis.

4B.2 The licensee must ensure that, were it to exit the supply market (due to insolvency, licence revocation or in any other circumstances), said exit would be an Orderly Market Exit.

~~4B.1~~ 4B.3 The licensee shall at all times manage responsibly costs that could be Mutualised and take appropriate action to minimise such costs.

Meeting the financial responsibility principle

~~4B.2 The licensee shall at all times have adequate financial arrangements in place to meet its costs at risk of being Mutualised.~~

4B.4 If the licensee supplies to Domestic Premises, with effect from 31 March 2025, the licensee must, at all times, maintain the 2025 Minimum Capital Requirement.

~~4B.3~~ 4B.5 Where the licensee uses a Material Economic and Operational Asset to meet any of its obligations under this condition, the licensee must have Sufficient Control over it.

~~4B.4~~ 4B.6 The licensee shall not liquidate, sell or otherwise dispose of Material Economic and Operational Assets it uses to meet any of its obligations under this condition, if doing so risks an increase in costs at risk of being Mutualised.

4B.7 If the licensee does not, at any point in time after the effective dates at 4B.4 , hold the 2025 Minimum Capital Requirement as required by standard condition 4B.4 or if any of the Trigger Points have occurred, it must notify the Authority 28 days before making any payment, providing any loan or transferring any asset to any third party unless that payment, loan or transfer is one that it is essential to the licensee's operation as a supplier of gas and electricity to consumers.

Directing the Protection of Domestic Customer Credit Balances

4B.8 The Authority may direct the licensee to Protect a proportion of its Domestic Customer Credit Balances in accordance with standard condition 4D where the Authority's Supervisory Financial Monitoring data, any data or information the Authority receives by way of notification under standard condition 4B.12 and/or any other relevant data that the Authority receives or obtains indicates that: (i) the licensee is not meeting the financial resilience standards set out at the following standard conditions; or (ii) there is a Material risk that it will not meet the financial resilience standards set out at the following standard conditions within the next 12 month period:

- 4B.1:

- 4B.2;
- 4B.3 in circumstances where Gross Credit Balances net of Unbilled Consumption exceed Total Assets beyond 50%, or where the supplier forecasts that they will exceed that level;
- 4B.4;
- 4B.5; and
- 4B.6 in circumstances where there is a risk of a Material increase in costs at risk of being Mutualised.

4B.9 A direction under standard condition 4B.8 will in particular provide the Adjustment Percentage the licensee must apply for the purposes of standard condition 4D. Said Adjustment Percentage will be no less than 0% and no more than 100%. In determining the Adjustment Percentage, the Authority will consider Consumer Interests and will review the Supervisory Financial Monitoring data that it has in relation to the licensee and any other relevant data that it has obtained or received from any other sources, and direct an Adjustment Percentage which:

- will not have an adverse effect on the licensee's ability to finance its activities such that the level of the Adjustment Percentage is likely to cause the licensee to exit the market due to insolvency; but

- where if the licensee were nevertheless to exit the market or have its licence revoked, minimises, as far as is possible, the Mutualised costs that would be caused by any such market exit or licence revocation.

4B.10 Before giving a direction under standard condition 4B.8 the Authority must inform the licensee of its intention to do so in a Notice that:

(a) states the date on which it is propose that the direction should take effect;

(b) sets out the Authority's reasons: (i) for the direction; and (ii) for the level of Adjustment Percentage;

(c) specifies the time (which must not be less than a period of 7 days from the date of the Notice) within which representations with respect to the proposed direction may be made,

And must consider any representations that are duly made by the licensee and not withdrawn.

4B.11 The Authority's power to give a direction under standard condition 4B.8 includes the power to revoke that direction upon notice to the licensee following consultation.

#### Monitoring and Reporting

4B.12 The licensee must notify the Authority in writing: (i) as soon as reasonably practicable after it becomes aware that there is Material risk that it will not hold the 2025 Minimum Capital Requirement or that there is Material risk that any of the Trigger Points will occur; and (ii) as soon as reasonably practicable after it becomes aware that it does not hold the 2025 Minimum Capital Requirement or that any of the Trigger Points have occurred.

4B.13 Unless and so far as the Authority otherwise consents, the licensee must:

- a. comply with the Guidance on standard condition 4B, a document that will be incorporated into this licence by way of direction under paragraphs 4B.14 to 4B.19;
- b. record the information detailed in the Guidance (“Specified Information”); and
- c. provide such Specified Information to the Authority in respect of such periods and within such timeframes as are specified in the guidance document.

Guidance

~~4B.5 The licensee must have regard to any guidance on standard condition 4B (including in respect of definitions which appear in standard condition 1) which, following consultation, the Authority may issue and may from time to time revise.~~

4B.14 The Authority will issue and amend the Guidance by direction.

4B.15 The Authority will prepare and publish the Guidance on the Authority’s website. The Authority may amend the guidance document from time to time in accordance with paragraph 4B.16.

4B.16 The Guidance will make provision for:

4B.17 how the Authority intends to monitor and assess in respect of the licensee’s financial circumstances, including

- a. guidance on the Minimum Capital Requirement and how licensees should meet this.
- b. the form, manner and/or the frequency with which the Specified Information must be provided to the Authority; and
- c. an explanation of why the Specified Information is required.

4B.18 Before issuing the Guidance document by direction, the Authority will publish on the Authority’s website:

- d. the text of the proposed Guidance;
- e. the date on which the Authority intends the Guidance document to come into effect; and
- f. a period of not less than 10 days during which representations may be made on the content of the Guidance.

4B.19 Before amending the Guidance document, the Authority will publish on the Authority’s website:

- g. The proposed text of the new or amended Guidance document;
- h. the date on which the Authority intends the new or amended Guidance document to come into effect;

- i. the reasons for the amendments to the Guidance document; and
- j. a of not less than 10 days during which representations may be made on the amendments to the Guidance document.

4B.20 Definitions:

**2025 Minimum Capital Requirement**

means licensee Net Assets of XX per Domestic Customer or access to an alternative source of funding with equivalent effect such as, but not limited to, long term unsecured debt or similar financial instruments, access to undrawn credit facilities, a guarantee from a third party provided that alternative source is notified to the Authority in writing no later than 12 weeks before the date provided for in standard condition [4B.6] and in respect of new market entrants within 28 days of the grant of the [gas/electricity] supply licence and meets the Alternative Source Conditions.

**Alternative Source Conditions**

are:  
that the alternative source must be sufficient to ensure that the licensee can meet any risks or liabilities that the licensee reasonably anticipates;

where the alternative source is held by the licensee (unsecured debts or similar financial instruments), it must not be secured on licensee assets by a fixed or floating charge or other security arrangements.

and where the alternative source is held by a third party:

- the licensee must have robust, legally enforceable, and clearly defined arrangements in place to ensure that it can draw on that funding at all times, including in times of financial stress.
- said arrangements should not be capable of termination without good cause and without sufficient notice to enable the licensee to put in place arrangements to meet the Minimum Capital Requirement in another way.

- the third party must have, an maintain, long term credit rating of not less than BBB by Standard and Poor's or equivalent rating by either Moody's or Fitch Ratings.

**Adjustment Percentage**

Has the meaning given to its at standard condition 4D

**Capital**

Means the elements of a supplier's equity and appropriate loss-absorbing debt liabilities which rank behind general creditors, such as share capital and retained earnings, and subordinated debt.

**Consumer Interests**

means the likely impact of any adjustments on Resilience, Prices, Quality and Standards and Low-Cost Transition to Net Zero.

**Domestic Premises**

Means premises at which a supply is taken wholly or mainly for domestic purposes

**Liquidity**

Means the resources that suppliers can convert into 'cash' as soon as needed and with minimal loss in value to meet liabilities as they fall due, including under adverse circumstances.

**Low-Cost Transition to Net Zero**

means the ability of gas / electricity supply licence holders to take the appropriate steps, at lowest cost to consumers, toward an energy system which relies on renewable, zero-emission sources and [to] facilitate the use of zero emission technologies that are connected to the energy network

**Material**

means more than negligible (de-minimus)

**Material Economic and Operational Assets**

those assets, mechanisms or arrangements used or needed by a supplier: to run its supply business and meet its obligations with regards to customers; to manage responsibly its costs at risk of being Mutualised; as adequate financial arrangements to meet its costs at risk of being Mutualised, with such assets, mechanisms or arrangements including, but not limited to, premises, facilities, staff, equipment, IT system, brand name and hedging contracts.



<b><u>Mutualisation [ /Mutualised]</u></b>	<u>Has the meaning given to it at standard condition 1</u>
<b><u>Net Assets</u></b>	<u>(fixed assets + current assets) – (current liabilities + long-term liabilities)</u>
<b><u>Orderly Market Exit</u></b>	<u>An exit where the licensee has ensured that its operational and financial arrangements are such that: any Supplier of Last Resort or special administrator appointed will be able to efficiently and effectively serve its customers and the exit will not result in Material Mutualised costs.</u>
<b><u>Prices</u></b>	<u>means Charges for the Supply of [Gas / Electricity]</u>
<b><u>Protect</u></b>	<u>Has the meaning given to it at standard condition 4D</u>
<b><u>Quality</u></b>	<u>Characteristics that make a source of funding best suited to allow a firm to absorb losses unambiguously on an ongoing basis, including under adverse circumstances.</u>
<b><u>Quality and Standards</u></b>	<u>means the extent of competition, innovation and level of customer service in the market</u>
<b><u>Resilience</u></b>	<u>means the proportion of the Market at Risk of Failure and the likely Mutualised cost that would result in the event of that failure occurring.</u>
<b><u>Sufficient Control</u></b>	means having either direct ownership or legally enforceable rights over Material Economic and Operational Assets so that the licensee can legally rely on them and enjoy the benefit of them.
<b><u>Supervisory Financial Monitoring</u></b>	<u>means the processes by which the Authority obtains information about the financial position of licence holders with such information including, but not limited to, licensee hedging position, the level of assets and liabilities held by the licensee, and the licensee's ability to meet its debts as they fall due.</u>

**Trigger Point**

are indicators linked to supplier financial resilience set out in the Guidance.