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Modification proposal:	**Distribution Connection and Use of System Agreement (DCUSA) Change Proposal (CP) 409 – Change to Credit cover calculations to include Last Resort Supply Payment (DCP409)**		
Decision:	The Authority[1] has decided to reject[2] this modification[3]		
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested parties		
Date of publication:	03 March 2023	Implementation date:	n/a

Background

The current system of credit protection for Suppliers[4] in the electricity industry involves the requirement to provide Collateral[5] equal to or greater than the Supplier's Value at Risk[6] to protect Distribution Network Operators (DNOs) from unpaid charges. This Collateral can be provided in the form of letters of credit, escrow account deposit, cash or any other forms of Collateral as agreed between parties. In the event of a Supplier failure, outstanding charges are spread across other Suppliers, which may then be passed on to customers.

Currently, when calculating the Value at Risk for Suppliers, any Last Resort Supply Payments[7] which are due to Suppliers following valid claims made through the Supplier of Last Resort (SoLR) process and due to be paid to Suppliers by DNOs in the future are not

[1] References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.
[2] This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.
[3] 'Change' and 'modification' are used interchangeably in this document.
[4] Supplier is defined in DCUSA Section 1A – Preliminary –Definitions and Interpretation.
[5] Collateral is defined in DCUSA Section DCUSA Schedule 1 – Cover DCUSA Schedule
[6] Value at Risk DCUSA Schedule 1 – Cover DCUSA Schedule 1
[7] Last Resort Supply Payments is defined in the Distribution licence Section A: Standard Conditions for all Electricity Distributors – Condition 1. Definitions for the standard conditions

included in the calculation. The costs of providing these forms of Collateral are likely to be passed on through customers' bills.

The modification proposal

DCP409 was raised by British Gas Trading Limited (the "Proposer") on 10 May 2022. The intent of the modification is to define a Valid Claim[8] for a Last Resort Supply Payment within the DCUSA and to allow these payments to be included in a Supplier's Value at Risk calculations. Valid Claims can be made by Suppliers following the onboarding of customers from a failed Supplier under the SoLR process to cover additional costs incurred. As payments are currently made monthly or quarterly following a successful Valid Claim, the proposed solution would take the payments into account on a monthly basis in Value at Risk calculations rather than the full value of the claim. The Proposer believes that this could lead to a reduction in the level and costs of Collateral that Suppliers are required to provide, potentially reducing costs for Suppliers and lowering customers' bills within a competitive market.

There were two options proposed during the development stage for including Valid Claims in Value at Risk calculations and these are:

- Option A – The inclusion of the value of the next monthly payment only due to a Supplier in relation to a Valid Claim for a Last Resort Supply Payment in the Suppliers Value at Risk calculation.
- Option B – The inclusion of the value of all monthly payments not yet paid to a Supplier in relation to a Valid Claim for a Last Resort Supply Payment in the Supplies Value at Risk Calculation.

During the voting stage, parties were asked to express a preference on the above proposed options. DNO parties stated a preference by majority for Option A. Supplier parties stated a unanimous preference for Option B as their preferred method of implementation.

[8] Valid Claim is defined in the Distribution licence Section A: Standard Conditions for all Electricity Distributors – Condition 1. Definitions for the standard conditions

It should be noted that the preference for choice of the proposed options during the vote on DCP409 were not raised as official alternate versions of the modification itself. The preference only represents the option which parties would prefer to see implemented.

DCUSA Parties' recommendation

The outcome of the voting was that there was unanimous support for the proposal and its proposed implementation date from the Supplier party category. However, the majority of DNO parties voted against DCP409 and its proposed implementation date. It is noted that no votes were cast in the IDNO or CVA Registrant party category.[9]

In accordance with the weighted vote procedure, the recommendation to the Authority is that DCP409 is rejected regardless of the preference of the variations. The outcome of the weighted vote, disaggregated by preference of the options, is set out in the table below:

DCP409	WEIGHTED VOTING (%)							
	DNO[10]		IDNO/OTSO[11]		SUPPLIER		CVA[12] REGISTRANT	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
Option A	35% (First choice)	65%	n/a	n/a	100% (Second Choice)	0%	n/a	n/a
Option B	35% (Second Choice)	65%	n/a	n/a	100% (First Choice)	0%	n/a	n/a
Implementation Date	35%	65%	n/a	n/a	100%	0%	n/a	n/a

Our decision

[9] There are currently no gas supplier parties.
[10] Distribution Network Operator
[11] Independent Network Operator
[12] Central Volume Allocation

We have considered the issues raised by the proposal, the Change Declaration and Change Report dated 24 January 2023. We have considered and taken into account the vote of the DCUSA parties on the proposal which is attached to the Change Declaration We have concluded that:

- implementation of the modification proposal will not better facilitate the achievement of the Applicable DCUSA objectives.[13]

Reasons for our decision

We consider that DCP409, and both proposed variants within it, will negatively impact Applicable DCUSA Objective (b) with a neutral impact on the other Applicable Objectives.

Applicable DCUSA Objective (b) – the facilitation of effective competition in the generation and supply of electricity and (so far as is consistent with that) the promotion of such competition in the sale, distribution and purchase of electricity.

The Proposer is of the view that this modification will better facilitate Applicable DCUSA Objective (b) by allowing Suppliers to include Last Resort Supply Payments into their Value at Risk calculations. This in turn may be able to reduce their own costs in providing Collateral and this could potentially lead to a reduction in customers' bills. The Proposer also asserts that this may lead to an increased participation from Suppliers to voluntarily take part in the SoLR process.

Respondents to the consultation had mixed views in relation to whether this proposal will better facilitate DCUSA Objective (b). One respondent in support of the modification believed that allowing Suppliers to include these payments in their Value at Risk calculations would make participating in the SoLR process more appealing to Suppliers. The same respondent believes that this would allow Suppliers to fully utilise all their assets as opposed to these being tied up in Value at Risk calculations. While another respondent who disagreed that the modification would better facilitate DCUSA Objective (b) noted this potential benefit may only be available to a limited group of Suppliers who are appointed by Ofgem as a SoLR. The same respondent was of the view that a small

[13] The Applicable DCUSA Objectives are set out in Standard Licence Condition 22.2 of the Electricity Distribution Licence.

number of Suppliers are regularly appointed to become SoLR's and the benefits are likely to be restricted to these Suppliers.

We do not consider that the final Change Report has provided sufficient evidence that DCP409 and either of its variants, A or B, will lead to an increased participation from Suppliers to voluntarily take part in the SoLR process. We have also not been given any evidence that this modification will deliver additional benefit to Suppliers who Ofgem may direct to take part in the SoLR process following the published SoLR guidance. It is also unclear how any potential reduced costs for Suppliers would be passed on to consumers due to the preference for payments to be included monthly in calculations.

We also would expect that any variations of a modification that is raised would be classed as an official alternative to the main modification. Alongside this we would assume that each alternate would be independently considered and assessed against each objective separately with all supporting evidence included within the final documentation.

The Proposer states that by defining a Valid Claim within DCUSA this will allow Suppliers greater choice in the types of Collateral to be used in Value at Risk Calculations. The requirement to provide Collateral is to ensure that DNOs are protected in the event that a Supplier is unable to cover their outstanding charges. However, a respondent noted that the requirement to pay Valid Claims for Last Resort Supply Payments is set out in the Distribution Licence under condition 38B[14]. Licence condition 38B.3 Obligation to Pay a Claimant states that "where the licensee receives a Valid Claim, the licensee must make payments to the Claimant, by monthly or quarterly instalments commencing three months after the date on which the Valid Claim is received, and in any event by no later than 15 months from the date on which the Valid Claim was received."[15]

If DCP409 were approved and either variant A or B implemented, a Supplier in receipt of a Last Resort Supply Payment and using these as Collateral finds itself in a situation where it is at risk of default may find it has insufficient Collateral in place or is unable to raise enough Collateral of other forms to cover the value of the Last Resort Supply Payments currently used to prevent defaulting. If these charges remained unpaid, there

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[14] Licence condition 38B Treatment of payment claims for last-resort supply where Valid Claim is received on or after 1 April 2019 in the Distribution licence

[15] Distribution Licence Chapter 9 Condition 38B. Treatment of payment claims for last-resort supply where Valid Claim is received on or after 1 April 2019

is the risk that these charges could be socialised across all suppliers resulting in increased costs for other Suppliers and ultimately being passed on to consumers while the Supplier continues to benefit from the receipt of their Last Resort Supply Payments due to the licence requirement to pay these.

We believe this could lead to the current rules in DCUSA Schedule 1 Section 1 'Provision of Cover' being undermined and Suppliers who are appointed as a SoLR may be seen to be rewarded a reduction in the cost of providing Collateral at the possible detriment of other Suppliers in the market. We believe this may give an unfair advantage to Suppliers appointed as a SoLR and could lead to reduced competition within the market which would have a detrimental impact on Objective (b). Based upon all evidence submitted to us, we do not believe that the implementation of DCP409 - either Option A or B - will better facilitate relevant DCUSA Objective (b).

Decision notice

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority has decided that DCP409: 'Change to Credit cover calculations to include Last Resort Supply Payment' should not be made.

Michael Walls

Head of Retail Market Operations

Signed on behalf of the Authority and authorised for that purpose