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Dear David,

STATUTORY CONSULTATION: STRENGTHENING FINANCIAL RESILIENCE

Thank you for the opportunity to comment on Ofgem's statutory consultation on proposals relating to strengthening the financial resilience of suppliers and in particular ensuring that suppliers bear the appropriate cost of risk-taking, are more resilient to market shocks and that customers are shielded from the impact of supplier failures as far as possible.

The consultation is seeking stakeholder views on the following:

- Protections for Renewable Obligation (RO) payments
- Proposals to enhance the Financial Responsibility Principle within SLC 4B including:
    - Requiring suppliers to hold a minimum level of capital by end March 2025
    - Implementing additional regular annual reporting on financial resilience and in relation to specific trigger points on an ongoing basis
    - Giving Ofgem powers to direct suppliers to protect Customer Credit Balances in certain circumstances

Our responses to the specific questions are set out in Annex 1 to this letter. We have also provided high level comments on the draft guidance in Annex 2 and comments on the draft licence conditions in Annex 3. We would highlight the following key points.

<u>Inadequate consultation timescales</u>

We are concerned that a large number of detailed proposals in this statutory consultation are being made public for the first time with very limited time for parties to review and assess the impacts, noting the consultation period is only six weeks and covers the Christmas and New Year holiday weeks. In particular the amendments to SLC 4B (Financial Responsibility Principle) introduce numerous new detailed requirements in

relation to monitoring and reporting obligations which are accompanied by more than 25 pages of new detailed draft guidance.

We do not consider it is good regulatory practice for Ofgem to have introduced this large amount of detail in this statutory consultation without any prior informal consultation or stakeholder engagement. In view of this our response should not be regarded as definitive or exhaustive in relation to the draft licence conditions and guidance. We are concerned that this lack of scrutiny will risk unintended consequences and we would urge Ofgem to extend its timescales for implementing the new reporting regime to allow more thorough review by stakeholders.

Protecting Consumer Credit Balances & Capital Requirements

We are disappointed and disagree with Ofgem's decision not to require suppliers to protect or ringfence their customers' credit balances. Ofgem has acknowledged from the inception of the Supplier Licensing Review in 2018 that consumer credit balances form the biggest proportion of costs that are mutualised due to suppliers' financial insolvency and so by extension the biggest proportion of consumer detriment. Further, we have consistently reiterated that failure to protect credit balances introduces unnecessary "moral hazard" by providing a significant amount of cost-free finance which some suppliers may rely on in place of committing their own equity, to sustain unduly risky and financially irresponsible behaviour. In our view the proposed minimum capital requirements are an inadequate substitute for obligations on suppliers to ringfence or guarantee their customers' credit balances.

We think the proposed range of minimum capital (£110 to £220 per customer) is too low and when coupled with the two year implementation period will prove a very weak protection against suppliers pursuing financially irresponsible and unsustainable business models. The timescales for this statutory consultation are too short for us to assess and propose alternative requirements, but we will consider this after the response deadline and follow up with Ofgem as appropriate. Should Ofgem implement these proposals on its implied short timescales, we would recommend that, as a minimum, a process enabling regular review and revision of the level of the minimum capital requirement is explicitly set out in SLC 4B.

Monitoring and Reporting Requirements

We are concerned that Ofgem's proposed financial reporting and notification requirements will cut across much of what financially responsible suppliers will already have in place. We think there is a likelihood that Ofgem's proposals will not align with suppliers' existing reporting arrangements, instead requiring similar information to be presented in ways that will involve significant additional resource. Of greater concern is the possibility that the threshold level of financial developments and incidents that needs to be notified to Ofgem may be lower than that typically required by finance providers and investors. As such, there is a risk that Ofgem's proposed licence requirements could themselves precipitate financial instability or even insolvency.

We believe one way to avoid these risks would be to make use of credit ratings from leading agencies (Moody's, Standard & Poor's, Fitch) as these agencies routinely engage with companies to monitor and understand many, if not all, of the commercial and financial factors Ofgem is seeking to capture. In this context we would propose that SLC 4B should be further modified such that suppliers that can maintain an investment grade credit rating would not be subject to the full proposed reporting, notification and triggers for intervention unless downgraded. Instead, Ofgem could simply monitor the supplier's credit rating, freeing up time and resource for Ofgem to focus on more

financially risky licensees. Furthermore, Ofgem should align notifiable items with what would be expected by a typical finance provider, ie adverse material effects, and not seek lower-level information. We have reflected these points in proposed amendments to Ofgem's draft guidance in Annex 2 and licence conditions in Annex 3.

Renewables Obligation

While we are disappointed with Ofgem's overall package of financial resilience measures we are pleased Ofgem is proceeding with its proposals to require suppliers to ringfence funds to meet their RO liabilities. RO defaults have formed a significant proportion of mutualised costs arising from supplier insolvencies, though lower relative to credit balances. In this context, ringfencing liability amounts will materially contribute to the avoidance of future insolvencies and mutualised costs and therefore deliver substantial consumer benefit. We believe there may be a way for suppliers to circumvent the ringfencing requirements and would recommend advance notification of RO certificate disposals would remedy some of this.

Please do not hesitate to contact me or my colleague Haren Thillainathan (hthillainathan@scottishpower.com) if you have any questions arising from this response.

Yours sincerely,

Richard Sweet
Director of Regulatory Policy

Annex 1

STATUTORY CONSULTATION: STRENGTHENING FINANCIAL RESILIENCE– SCOTTISHPOWER RESPONSE

Chapter 1: Introduction

Question 1: Do you agree with our package of proposals and overall approach?

We are supportive of Ofgem's programme of activity to improve financial resilience of suppliers, however as we have shared in engagement over several years now, we believe Ofgem has acted too slowly to require suppliers to protect funds that would be mutualised on a disorderly supplier exit. This lack of action has led to significant levels of mutualised costs being passed to consumers as a result of the exit of a number of suppliers who were not operating in a financially resilient manner.

While we are therefore pleased that Ofgem is moving forward with proposals to require suppliers to protect RO payments and has started the process to move towards a requirement to hold minimum capital, we are disappointed that Ofgem is not progressing with proposals to require suppliers to protect credit balances. We recognise that longer term requirements to hold minimum capital may provide the required protection in relation to credit balance cost mutualisation exposure, however with this not due to be in place until the end of March 2025, we are concerned that Ofgem is leaving a risk in the market. As we set out in response to Question 5, we think the trigger proposals that could prompt Ofgem to direct suppliers to protect credit balances in certain circumstances are likely to be ineffective, as they would require action by suppliers too late when they are already in distress, and in many (or potentially all?) cases, may never be triggered as doing so would contribute to the supplier failing.

Ofgem has at this last stage of statutory consultation, normally reserved for refining previously consulted-on policy proposals, introduced significant additional reporting requirements on suppliers, none of which has had any policy consultation prior to this statutory consultation stage. It is not usual process for Ofgem to introduce completely new policy proposals at the statutory consultation stage, and we consider that such an approach is particularly unreasonable given the volume of those proposals and the significant consequences for both market participants and consumers which are likely to flow from their implementation. While we have reviewed and commented on the proposals as fully as we can, the quantity of material was significant (100-page consultation, 35 pages of guidance, 77 page impact assessment, alongside almost 25 pages of new licence conditions for each of gas and electricity); and the timescales for review were very short and coincided with the festive period, a number of other regulatory responses, and for ScottishPower our year end accounting process. We do not consider that the 3 January 2023 deadline provided adequate time for stakeholders to consider and respond to the proposals. While we reiterate that we do not disagree with Ofgem taking action in this area, we are concerned about the potential for unintended consequences of the approach Ofgem is taking to policy development, which limits the ability of stakeholders to properly scrutinise the proposals and does not, in our view, amount to fair consultation.

Therefore, while we have set out our views and comments within this response and have included commentary on the guidance and each of the draft licence conditions as relevant, we do not consider we have had sufficient time to properly review all the documentation and proposals, notably for the new reporting obligations. We consider there remains a reasonable risk of unintended consequences from Ofgem's proposals as we do not believe they will have had sufficient scrutiny, being introduced at statutory consultation stage with no prior assessment.

Chapter 2: Enhanced Financial Responsibility Principle

Question 2: Do you agree with our proposal to enhance the FRP to require suppliers to ensure there is no significant risk that liabilities cannot be met as they fall due?

Yes, we agree with Ofgem's proposal to introduce a new requirement within the Financial Responsibility Principle to ensure suppliers are able to meet their liabilities as they fall due on an ongoing basis.

Question 3: Do you agree with our proposed approach to FRP reporting, including Trigger Points and annual self-assessment reporting?

As we have noted above, we are generally supportive of Ofgem's actions to improve supplier financial resilience, however we have a number of concerns regarding the process Ofgem is following, notably the introduction of completely new policy proposals at the statutory consultation stage.

Ofgem's proposals for FRP reporting take the form of almost 10 pages of licence conditions each for gas and electricity, and 35 pages of guidance, of which 21 pages relate to the new requirements proposed for FRP reporting. None of this has been shared with suppliers prior to this consultation, and we are concerned that there is a risk that this could result in poor regulatory outcomes as there has been insufficient time for proper scrutiny by stakeholders.

We have a number of comments to make on Ofgem's proposals. We set these out below, but would also point Ofgem to the detailed comments we have provided in Annex 2 to this letter on the draft guidance issued by Ofgem in follow up to this consultation on 5 December.

Timescales and Resource

Ofgem provides no detail in any of the documents as to when it expects the new reporting obligations to commence, other than a statement (paragraph 3.36 of the draft guidance) that Ofgem *"will notify suppliers when they need to submit reporting".* We would flag to Ofgem that from our review of the extent of the requirements, notably for the annual self-assessment reporting, this is a significant set of reporting, akin to annual accounting reporting. Suppliers will therefore need a significant lead-in time to be able to provide this as currently specified. It has been suggested to us informally (bilateral meeting on 12 December) that reporting could be required in April 2023. We do not consider this to be feasible and ask Ofgem to allow at least six months from the date of its decision, to ensure suppliers can adequately resource and prepare for this completely new set of reporting.

Proportionality

Ofgem notes that it expects that suppliers will be undertaking similar monitoring and have existing documentation that it could use to meet these requirements. While we agree that this is likely to be the case to some extent, Ofgem's guidance sets out a vast set of prescriptive requirements for what the reporting needs to include. In in our view, we would not be able to provide this using existing reporting without adding significant effort and resource to ensure we are delivering on all of the requirements set by Ofgem. We do not therefore agree with Ofgem's assessment that the approach it has described within the licence conditions and guidance is proportionate, as we do not consider that any supplier would have this detail easily available in the format and addressing each of the areas Ofgem considers must be included.

Use of guidance rather than licence conditions

While we accept that there is material that is not proportionate for inclusion in the licence conditions, we are also concerned that Ofgem is in this case circumventing the statutory protections under the 1989 Act modification regime by inserting key elements of the proposals (and prescriptive rules) into guidance with which suppliers are obliged to comply.

By contrast, changes to licence conditions are generally subject to much greater scrutiny though the statutory consultation process, and importantly, give rise to a right of appeal to the CMA. This framework provides an important level of protection for licensees (and their investors). Ofgem should place such enforceable regulatory obligations, and other key elements of the relevant provisions, in the licence not in guidance.

We have set out in Annex 2 some comments on the guidance based on the review we have been able to complete in the timescales, but will follow up to provide further comments on this aspect of Ofgem's proposal as appropriate

We note that the proposed SLC 4B.18 provides that the guidance can be varied with as little as 10 working days' notice to suppliers but would urge Ofgem to provide longer timescales for scrutiny of any proposed amendments to guidance. We consider Ofgem should allow a minimum of four weeks rather than 10 working days for review of any proposed changes. The guidance is now a substantive document, having been extended by almost 25 pages as a result of this consultation, and now covers three separate licence conditions. We do not consider 10 working days to be a sufficient period for stakeholders to review, understand and comment on changes. It will also be important that Ofgem considers suitable implementation timescales for changes. While minor changes may have little impact, many of the topics within the guidance may take longer for suppliers to prepare for and implement.

Trigger Point monitoring

Ofgem is proposing placing obligations on a supplier to monitor for a number of "Trigger Points" and then to notify Ofgem where a trigger event occurs or where it assesses there is a risk that a trigger will occur. The Trigger Points are defined within the guidance document and include:

- Material changes in access to funds
- Changes in profit/revenue/liquidity
- Change and/or potential failure of counterparties
- Changes to hedging position
- Changes in net assets/net liabilities
- Reliance on customer credit balances
- Meeting the minimum capital requirement following 31 March 2025

We have provided comments on the drafting of the trigger definitions in Annex 2. In summary, we consider that the current drafting is far too vague in places and risks contributing to real challenges for suppliers to operationalise.

Aside from these points (on which we comment more below), we consider it is unlikely that a supplier would be able to maintain an investment grade credit rating if any of trigger events had occurred. Given the level of scrutiny companies with investment grade credit ratings are subject to from external credit rating agencies, we would propose that Ofgem creates a "carve out" from the trigger reporting obligations for suppliers with such ratings. This would support Ofgem resource in monitoring suppliers without investment grade credit ratings who present

more financial risk. This would help support the policy proposal in being proportionate as Ofgem is intending.

We also consider these draft requirements could create potential unintended consequences. For example, as drafted, we believe the proposals could require suppliers to notify Ofgem of less material financial events than would be required in contracts with external finance providers. If this is the case, we have concerns that the requirement to notify Ofgem could itself trigger a consequential requirement to notify finance providers, where it would not otherwise (in the absence of Ofgem's licence conditions) have been necessary to notify the finance provider. This could lead to withdrawal of funding or increased terms leading to further instability in the market and contributing to potential supplier failure. We therefore think it important that Ofgem aligns any trigger reporting with the requirements that are usual within external funding arrangements (eg notification of material adverse events) to avoid such unintended consequences.

Question 4: Do you agree with our proposal regarding the notification and monitoring approach for reliance on CCBs – including the proposed 50% of total assets threshold – or would it be more beneficial to set a prescriptive maximum reliance on CCBs?

As we have noted in other parts of this response, we are disappointed that Ofgem has chosen not to progress with the requirement on suppliers to protect CCBs.

Ofgem is instead requiring a supplier to monitor CCBs (net of unbilled consumption) as a proportion of Total Assets and notify Ofgem where it identifies a risk that CCBs will be at or exceed 50% of Total Assets. Ofgem has not however defined Total Assets within any of the licence conditions. We assume it is proposing measuring Total Assets as the sum of Fixed Assets and Current Assets.

We are not convinced that Ofgem's proposal will protect consumers from the costs of credit balances being mutualised on supplier failure. While Ofgem's proposed licence conditions provide for it to direct suppliers to protect credit balances where a trigger point is breached, the obligation requires that Ofgem only do so if the requirement would not itself trigger the supplier to fail. We are concerned that in practice, Ofgem may find it very difficult to implement as where a supplier is holding such levels of credit balances, it is likely to be close to failure. Indeed, this could have the perverse outcome that, where two firms with the same CCB situation breach the trigger, Ofgem would take unnecessary action to secure the CCBs of the firm on a stronger financial footing and not reliant on the CCBs, but would be precluded from intervening in the company in a weaker financial position which is reliant on CCBs and is about to fail.

Ofgem asks in this question whether stakeholders think it would be more beneficial to set a prescriptive maximum reliance on CCBs. However, it is unclear what Ofgem would be proposing here. There is no suggested alternative within the consultation document to the monitoring proposal and therefore it is difficult to comment. If Ofgem were to set a maximum level of credit balances that suppliers could hold, it is not clear how Ofgem would monitor this and what action it would take if a supplier were to report that it held more than the set maximum at any point. Our view remains that Ofgem should require suppliers to protect credit balances.

Ofgem's argument appears to be that the costs are too high for credit balance, RO and minimum capital obligations, and is therefore focusing on RO and minimum capital at this point. However, as we explain in response to Question 6, we think the proposed range of minimum capital (£110 to £220 per customer) is too low and when coupled with the two year implementation period will provide a very weak protection against suppliers pursuing financially irresponsible and unsustainable business models.

If Ofgem decides to proceed with its proposed requirement on suppliers to monitor and report on the extent of their reliance on credit balances, we believe there should be an exception for companies that maintain an investment grade credit rating. The reason for this is the same as we have set out in our response to Question 3, namely that the financial risks indicated by an over reliance on credit balances and the other triggers are monitored by external credit rating agencies in determining their ratings. As such, an investment grade credit rating provides the market and investors with assurance that financial risks are well mitigated and therefore provides a reliable and publicly available indicator for Ofgem to monitor.

Question 5: Do you agree with our approach requiring notification by suppliers ahead of non-essential payments when in breach of the FRP, and regarding the ability to direct hard ringfencing of CCBs?

As we note in response to Question 4, we are not convinced that Ofgem's proposal to give itself powers to direct suppliers to protect credit balances will sufficiently protect consumers from the costs of credit balances being mutualised upon supplier failure. We are concerned that in practice, Ofgem may find it very difficult to exercise its powers since, where a supplier is holding such levels of credit balances, it is likely to be close to failure.

Ofgem is also proposing placing constraints on suppliers where a trigger event occurs by requiring notification 28 days before making any payment, providing any loan or transferring any asset to any third party unless that payment, loan or transfer is essential to the licensee's operation as a supplier of gas and electricity to consumers. While we understand the intent of Ofgem's proposals, it is not clear to us how this will operate in practice.

In particular, for suppliers who are part of a larger group, it is normal practice for cash to be moved between group companies and it is important that Ofgem does not create constraints that could interfere with efficient treasury management within a group of companies. By that we mean preventing the normal operational process and in effect leading to ringfence the supply company from the benefits of operating as part of the wider group. This would act to increase costs to the supplier with no benefit to consumers and we do not consider this to be Ofgem's intention with this proposal.

As noted in our responses to questions 3 and 4, if Ofgem decides to proceed with its proposals on trigger points and credit balances there should be an exception for companies that can maintain an investment grade credit rating. Given the underlying assessment inherent in an external investment grade credit rating, it provides assurance that financial risks are well mitigated and there no grounds for regulatory intervention.

Chapter 3: Minimum capital requirement

Question 6: Do you agree with our proposed approach to the minimum capital requirement, including our proposed longer-term trajectory as well as our transition minimum capital requirement for 2025? What is your view on our proposed range for the 2025 minimum capital requirement amount?

We are supportive of Ofgem's proposals to require suppliers to hold minimum capital by 31 March 2025. We maintain the view that requiring a minimum level of capital to be held will serve a dual purpose. First, it will support the reduction of any costs that would be mutualised if the supplier were to fail, but secondly, we consider it will provide a further layer of scrutiny of supplier finances, as whoever is providing the risk capital, be it the parent company or capital markets, will have a strong incentive to monitor the supplier risk management practices – and may be able to do so more effectively than Ofgem.

We are not convinced that the proposed initial level for 31 March 2025 of £110 to £220 per customer is sufficient. Our initial views are that this would not take account of any situations of stress on suppliers and would likely result in insufficient capital to protect consumers from any significant level of mutualised costs. With the short timescales provided to respond to this consultation we have not had time to undertake a detailed review to support us in providing a more informed response or to propose what we consider would be a suitable range. We welcome the reference by Ofgem in the consultation that it will continue to consult on the appropriate minimum level of capital, and we will share our views with Ofgem as that process continues.

Question 7: Do you agree with our proposed approach of setting the minimum capital requirement on a per-customer basis, or do you have a preference for a volumetric approach? In the case you prefer volumetric approach, what calculation method is most appropriate?

Again, we have not had sufficient time to review Ofgem's proposals in any detail, however our initial views are that costs that are at risk of mutualisation would generally scale with consumption rather than customer numbers, and therefore it would be more appropriate to have a volumetric approach to define the minimum capital requirements. We think Ofgem needs to undertake more analysis of this and again welcome the reference in the consultation document that it intends undertaking more consultation on this ahead of the implementation date of 31 March 2025.

Ofgem suggests that a per customer basis would be simpler and easier to enforce against, however we do not consider there would be any barriers to implementing a volumetric approach as Ofgem regularly requests consumption information from suppliers for other purposes, for example the setting of Government obligation targets.

Question 8: We set out a range of issues that may need to be considered in the future as we ratchet up the minimum capital requirement, including differences between tariff types and payment types. Do you agree with our proposal to consider these in future consultation, and to treat all tariff and payment types the same in our first minimum capital requirement? Do you have suggestions on how best to reflect the different drivers in the range of competitive tariffs versus SVT tariffs? Are there other elements that you think would be a significant driver of differences in capital needs across tariff offerings that we should consider?

We agree that there are a number of issues that should be considered in the future to ensure that the minimum capital requirement is set appropriately and delivers the required protections. We think it is sensible to consider these in a future consultation as the timescales for responding to this consultation do not allow stakeholders sufficient time to consider fully all of the key inputs and considerations.

Ofgem's current approach is to define the initial minimum capital requirement in as simple a manner as possible stating that this provides certainty for suppliers and reduces complexity. While we understand Ofgem's position, we think it is important that the minimum capital level is set at a level that does improve supplier financial resilience and does act to protect consumers from cost mutualisation if the supplier were to fail. We therefore consider it important that Ofgem consults on these issues and the process for increasing the minimum capital as early as possible.

In the longer run, there may be merit in setting the minimum capital requirement in a way that depends on a supplier's mix of customers, in particular payment method, tariff type and average consumption. Customer credit balances, in particular, will vary widely with payment method. We suggest the case for a customer mix-dependent minimum capital requirement is

considered further when the review of the EBIT allowance is further advanced and we have a better understanding of the drivers of overall capital employed.

Question 9: What is your view on our proposed approach to considering alternative sources of funding?

Ofgem's modelling for the minimum capital requirement is based on its modelling of a notional supplier who is equity financed without any long term liabilities. It does however recognise that alternative models for funding are in place across the market and it considers it reasonable to allow suppliers to propose alternative sources of funding subject to certain criteria being met. The alternative sources of funding would include long term debt, inter-company credit facilities and Parent Company Guarantees.

For such alternative funding, the criteria being proposed by Ofgem include:

- That the alternative source of funding must be sufficient to ensure that the licensee can meet any risks or liabilities that the licensee reasonably anticipates
- An alternative source of funding, such as debt or similar financial instruments, must not be secured on licensee assets by a fixed or floating charge or other security arrangements.
- Suppliers must have robust, legally enforceable, and clearly defined arrangements in place to ensure that they can draw on the source of funding at all times, including in times of financial stress.
- 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 an alternative way.
- The third party must have, and maintain, a long-term credit rating of not less than BBB by Standard and Poor's or equivalent rating by either Moody's or Fitch Ratings.

In addition, Ofgem proposes that if a supplier uses sources of funding held by a third party, they will also be required to obtain a legally enforceable undertaking from the external entity which states that the external entity will refrain from any action that would be likely to cause the licensee to breach any of its enhanced FRP obligations. This would need to be accompanied by evidence demonstrating how the funding will be legally transferred to the supplier, the terms and conditions of any funding (including payment terms of loans/ debt instruments) and satisfy Ofgem that the supplier is legally and readily able to access these funds.

We agree with Ofgem that alternative sources of funding should be allowed. It is important that the rules do not constrain suppliers from operating business models which are reasonable and may present efficiencies in terms of cost. We consider the criteria Ofgem is proposing to be reasonable to ensure that any alternative sources of funding are appropriate and will deliver the desired protections.

Chapter 4: Ringfencing RO receipts and CCBs

Question 9: Do you agree that suppliers should protect 100% of their RO (attributable to domestic supply) from the 2023/24 scheme year onwards on a backwards-facing basis? If not, what do you consider to be the optimal implementation period, and why?

As we have noted in all of our engagement and responses to date on proposals to protect RO payments, we remain of the view that amending the legislation underpinning the RO would have been the most efficient and effective way to prevent RO liability being mutualised across

consumers following supplier insolvencies. Addressing deficiencies in the current RO scheme design through supplier licence obligations is less effective, requiring considerable compliance and monitoring activity from Ofgem to ensure the policy intent is achieved.

In the context that legislative changes do not appear likely, we agree that suppliers should be required to protect their RO payments, and we agree with Ofgem's proposal for a 'protect or discharge through ROCs' approach. This option would require suppliers to evidence that their accruing RO obligation is being met on a quarterly basis either via holding ROCs, or protecting equivalent funds via an insolvency remote vehicle, or a combination of the two options. We think this option offers a number of benefits compared to the other options Ofgem has considered, including aligning more closely to the ROC scheme.

We also agree with Ofgem's proposal that the requirement would commence from April 2023 for the RO scheme year that commences at that point. We agree with Ofgem's proposals to have the full policy in place from April 2023 which represents the start of a new obligation period. We consider this should allow suppliers sufficient time to put in place the necessary protections and implement any changes to internal processes needed to support the new policy.

We also agree with Ofgem's preference for a backward facing approach to protections. This aligns to other similar schemes and with the accruing of the RO obligation itself, which means that suppliers should be well placed to administer the scheme. While it will create a risk of some costs being mutualised on supplier failure, we consider on balance it should still deliver significant improvements to the market in relation to incentivising responsible supplier behaviour with respect to treatment of RO obligations and mitigate mutualisation of RO costs.

We have however identified some areas within the proposals that we think Ofgem should consider further to ensure the proposals deliver their policy intent:

- We do not agree with Ofgem's proposal to limit the new requirement to domestic suppliers only. We see no reason why the RO protections would not apply to non-domestic suppliers in the same manner as domestic suppliers. While historically those non-domestic suppliers who have failed and contributed to RO mutualisation costs have been small, we do not consider this to be a strong justification for not considering requiring current non-domestic suppliers to protect their RO obligations in the same manner as domestic suppliers.

- Ofgem is proposing aligning the timescales with the quarterly Feed in Tariff levelisation schedule. While we are supportive of this approach as it seeks to protect the previous quarter's accruing obligation as quickly as possible, we would note that Ofgem only issues ROCs around two and a half to three months after the month of generation. For example, for April, May and June 2022, suppliers will only receive ROCs from generators after 21 July, 22 August and 21 September 2022 respectively, when Ofgem issues the generator with ROCs for each period.

  By aligning the RO protection requirements with the FIT levelisation schedule, then unless suppliers hold additional ROCs from previous obligation periods, they will need to use one of the approved forms of protection to demonstrate compliance with this obligation prior to receiving ROCs. As we noted, we think this could increase the implementation cost of the scheme for suppliers and ultimately consumers and potentially create double counting of protection where suppliers submit ROCs to the Register during the period but also have protection in place via one of the approved protection mechanisms.

- While we welcome Ofgem's proposals not to proceed with a requirement to create a trust fund for the proceeds of the sale of ROCs, we do however think that there remains a risk that an irresponsible supplier could seek to sell ROCs it holds in the register and has used to discharge its obligation without putting in place replacement or supplemental Protection Mechanisms to cover the increased level of buyout funds required by the licensee to discharge its RO following the sale of its ROCs. The current licence drafting includes a requirement for suppliers to notify Ofgem of any change in Protection Mechanism and not to remove the previous one until the new one is in place. This does not extend to the situation where a supplier was to sell ROCs it has used to discharge some or part of its obligation. We consider Ofgem should amend the licence conditions to require the supplier to:

    1. Put in place replacement or supplemental protections via one of the approved insolvency remote protection mechanisms to cover the increased required RO buyout fund liability (RO credit amount); and
    2. Notify Ofgem of the sale of ROCs, the amount involved and the resultant calculation of the revised/increased RO credit amount and confirm and evidence that it has put in place replacement or supplemental protections for its entire RO credit amount.

Question 10: How, and to what extent, might our proposals for RO ringfencing impact the way in which your company interacts with other Government schemes?

We do not consider that Ofgem's proposals would impact the way in which ScottishPower interacts with the RO scheme, or any other Government schemes.

Question 11: Would you envisage ringfencing your RO using a Protection Mechanism, protecting ROCs, or using a mixture of the two?

We expect to use a mixture of ROCs and a Protection Mechanism to meet this obligation. As we note in response to Question 9, due to the timescales of ROCs being issued, in practice unless suppliers hold ROCs from previous periods, it is unlikely that suppliers would be able to fully discharge their obligations via ROCs and therefore some element of Protection Mechanism will be required by almost all suppliers.

Question 12: Do you agree that the proposed price cap allowance is appropriate to account for the costs that an efficient supplier might incur in ringfencing their RO receipts? (See appendix 1)

We agree that the proposed allowance for the costs incurred in ringfencing RO receipts should be based on peak working capital requirements. Ofgem has calculated an annualised allowance of £7.90 per profile class 1 customer calculated as follows:

RO obligation rate (ROR)	ROC/MWh	0.491
RO buyout price	£/ROC	£52.88
Consumption	MWh/customer/year	3.1
Extra working capital to protect annual obligation	£/customer	£80.49
WACC	% per annum	10%
Cost of peak extra working capital held for year	£/customer	£8.05
Allowance (reversing out EBIT)	**£/customer/year**	**£7.90**

We disagree with Ofgem's use of 12 months' RO receipts as a measure of the peak requirement. Given that RO obligations do not need to be settled until 31 August of each year,

suppliers will be required to protect five quarters' worth of receipts during July and August (or six quarters if there is an obligation to protect the current quarters' receipts)[1]. We believe the allowance should be £9.87 (= £7.90 * 5/4) if five quarters' receipts are to be protected at the peak or £11.84 (= £7.90 * 6/4) if six quarters are to be protected.

Chapter 5: Protection Mechanisms

Question 13: What are your views on the minimum requirements that should be set for the Protection Mechanisms, including our proposals around minimum credit ratings?

We generally agree with the minimum requirements set out in the draft licence conditions for each of the proposed "approved" protection mechanisms. We would make the following points around the proposed minimum credit ratings and have suggested some amendments to the licence drafting in some cases in Annex 3.

- While we agree with the definition of Acceptable Credit Rating and the ratings are set at an appropriate level, we would suggest adding a long term debt rating threshold of A- with Standard & Poor's (this is equivalent to A3 from Moody's)

- For First Demand Guarantee, while we agree with the BBB threshold, we think this should be defined in a similar way to the Acceptable Credit Rating definition and explicitly state that the rating should be the long term rating of BBB or better with Standard & Poor's or the long term rating of Baa2 or better with Moody's.

Ofgem notes within the consultation document and licence conditions that it intends issuing forms for suppliers to use for various protection mechanisms and that these will be provided in the guidance. However, the guidance does not include any draft forms to allow suppliers to comment. Ofgem should issue these as early as possible to allow suppliers to comment.

[1] Although Ofgem's consultation talks about a backward-facing protection obligation, the definitions in SLC30 appear to suggest that the current quarter must also be protected. Specifically, the definition of 'Quarterly Cumulative Obligation' requires suppliers to protect 'the RO Quarterly Amount for that Quarter', where 'that Quarter' could be read as meaning the current quarter.

Annex 2

STATUTORY CONSULTATION: STRENGTHENING FINANCIAL RESILIENCE– GUIDANCE ON THE FINANCIAL RESPONSIBILITY PRINCIPLE – SCOTTISHPOWER RESPONSE

1. Introduction

This annex sets out ScottishPower's response to the revised guidance for SLC 4B issued by Ofgem on 5 December 2022 which Ofgem notes is intended to supersede the previous Financial Responsibility Guidance published in May 2022. We note that the guidance also covers areas relating to the Operational Capability Principle within SLC 4A, and now also applies to the new SLC 4D which is proposed to be introduced within the main Strengthening Financial Resilience Statutory Consultation.

2. Timescale for Review

As set out elsewhere in this response, we do not consider Ofgem to have provided sufficient time for review of what is a substantive change in policy from that consulted on prior to this point. This includes the timescales for review of the proposed amendments to the Guidance which now extends to 35 pages (an addition of almost 25 pages to the current version), with these only being published on 5 December, with a deadline of 3 January for responses.

We are concerned that the scale of changes being made to the Guidance and the short timescale for review is likely to result in less scrutiny than would be the case if Ofgem had allowed the usual longer timescales for review of substantive changes to policy. As a result, we consider there could be risk of unintended consequences and Ofgem should be open to ongoing engagement from suppliers after the 3 January requested date where any issues are identified within the Guidance from further review.

We therefore note that our comments provided here are perhaps more limited in nature than we would otherwise wish, as we do not consider we have been able to review the full set of documentation as much as we would normally choose to do.

3. Use of Guidance rather than Licence Conditions

As noted above, we are also concerned that Ofgem is circumventing the statutory protections under the 1089 Act by inserting prescriptive rules into guidance. The licence condition then provides for the guidance to be varied with as little as 10 working days' notice to suppliers for them to make representations. Changes to licence conditions are subject to much greater scrutiny (and rights of appeal) that those proposed by Ofgem for guidance, for good reason. Ofgem should place such enforceable regulatory obligations in the licence not in guidance.

4. Process and timescales for making amendments

Ofgem's licence conditions and indeed the guidance itself allows for a period of "not less than 10 working days" for any representations on any proposed changes to the guidance. We consider 10 working days to be far too short a timescale for suppliers to consider any changes to the guidance and consider Ofgem must set a minimum in line with the usual timescales for changes to regulatory obligations.

We consider Ofgem must allow a minimum of four weeks rather than 10 working days for review of any proposed changes. The guidance is a substantive document now, having been extended by almost 25 pages as a result of this consultation and now covers three separate

licence conditions. We do not consider 10 working days to be sufficient review period for stakeholders to review, understand and comment on changes, and as we note above, are concerned that Ofgem is by-passing normal consultation processes by relying on guidance rather than licence drafting. It will also be important that Ofgem considers suitable implementation timescales for changes. While minor changes may have little impact, many of the topics within the guidance may take longer for suppliers to prepare for and implement.

We also note that Ofgem is intending only publishing proposed amendments on its website. Even if Ofgem does extend the timescales for review, we consider it should take some action to notify impacted stakeholders, to ensure there is suitable visibility that Ofgem is proposing changes to the Guidance.

5. Proportionality and Application of Reporting

We think it is unlikely that a supplier would be able to maintain an investment grade credit rating if any of trigger events had occurred Given the level of scrutiny companies with investment grade credit ratings are subject to, we would propose that Ofgem creates a "carve out" from the trigger reporting obligations for suppliers with such ratings. This would support Ofgem resource in monitoring suppliers without reasonable credit ratings who therefore present more financial risk. We consider this would help support the policy proposal in being proportionate as Ofgem is intending. We have proposed amendments to Ofgem's draft SLC 4B in Annex 3, to reflect this.

6. Drafting of Triggers Points

We consider that the list of trigger points proposed by Ofgem is unnecessarily complicated and could be replaced by a notification requirement modelled on that typically used by finance providers. In essence, the triggers proposed by Ofgem all relate to factors that would impact a company's ability to remain a financial going concern. As such, company directors have fiduciary and legal responsibilities to ensure they are aware of such developments or "material adverse effects" to ensure their company remains a going concern. Finance providers therefore simply require that they are notified of any material adverse effects that could impact the company's ability to remain a going concern in order for it to access the financing facility. In this context, we would propose that the set of triggers proposed by Ofgem could be replaced with a single broader trigger definition based on the notification clauses found in typical financing agreement. For example:

> "Any material adverse change in the condition (financial or otherwise), business, properties, assets, liabilities, capitalisation, financial position, operations, results of operations or prospects of the Company and its Subsidiaries, taken as a whole, from the date SLC 4B has effect".

As noted above, we believe that companies with an investment grade credit rating should, nevertheless, be exempt from monitoring and reporting of any trigger points. Indeed, a downgrade from an investment grade credit rating would be due to a material adverse effect and therefore the credit rating constitutes an effective trigger point for Ofgem to monitor.

Notwithstanding the above points, we consider that the definitions of some of the Trigger Points are too vague/broadly drafted and could create unintended consequences if suppliers are obliged to report on them to Ofgem. We have provided detailed comments in the table below, in the event that Ofgem decides to proceed with its proposed approach.

Trigger	Definition	Comment
Material changes in access to funds	Suppliers must notify Ofgem of projected or actual Material changes to access to funds. This includes, but is not limited to, where suppliers identify scenarios where they may no longer have access to funds from an investor/parent company/ bank/lenders, or if funds or borrowings have been, or will be, reduced.	*Amend to avoid requirement to notify Ofgem of hypothetical scenarios that may be unlikely to occur (and other minor changes for clarity):* A supplier must notify Ofgem of projected or actual Material changes to access to funds. This includes, but is not limited to, where a supplier identifies a likely scenario where it may no longer have access to funds from an investor/parent company/bank/lenders, or if funds or borrowings have been, or will be, reduced.
Changes in profit/revenue/ Liquidity	Suppliers must notify Ofgem where there are Material changes to profit and/or levels that impact their ability to meet their liabilities as they fall due, and where they anticipate a drop in revenue over a certain period will lead to sustained losses, potential breach of debts or financial covenants.	*Amend to avoid requirement to notify Ofgem of anticipated losses that are not material (and other minor changes for clarity):* A supplier must notify Ofgem where there are Material changes to profit and/or levels that impact its ability to meet its liabilities as they fall due, and where it anticipates a drop in revenue over a certain period will lead to sustained losses~~,~~ that risk potential breach of debts or financial covenants.
Change and/or potential failure of counterparties	Suppliers must notify Ofgem where a likely failure of a counterparty may have a Material impact on their ability to meet their liabilities as they fall due. When making this assessment, suppliers should consider: - changes in the creditworthiness or the default of a counterparty, which may result in direct losses for the supplier or the need to revalue or replace transactions. - changes in market conditions which may result in the supplier incurring greater costs to replace a transaction that the counterparty has failed to settle. - the risk that collateral received from the counterparty may not be as effective as expected at covering the losses arising from that counterparty's failure or default.	*We suggest referring to 'a supplier' in the singular for consistency with licence conditions which refer to the licensee in the singular.*

Trigger	Definition	Comment
Changes to hedging position	Suppliers should notify Ofgem where changes to their hedging position may have a Material or sustained impact on whether a supplier can continue to meet its obligations under the FRP.	*We suggest amending as follows to avoid the obligation to report on a sustained but immaterial impact (and other minor changes for clarity):* A supplier should notify Ofgem where changes to its hedging position may have a Material ~~or~~ and sustained impact on whether it can continue to meet its obligations under the FRP.
Changes in Net Assets/net liabilities	Suppliers should notify Ofgem where they anticipate Material changes to their Net Assets and/or net liabilities may have a Material impact on the suppliers' ability to meet the FRP, including loans, dividends, and value redistribution within a group.	*We suggest adding 'sustained' (and other minor changes for clarity):* A supplier should notify Ofgem where it anticipates Material changes to its Net Assets and/or net liabilities (including loans, dividends, and value redistribution within a group) may have a Material and sustained impact on its ability to meet its obligations under the FRP,
Reliance on customer credit balances	Suppliers must notify when Gross CCBs net of Unbilled Consumption represent the equivalent of 50% or more of their total assets, and as soon as reasonably practicable when they become aware there is a Material risk of this occurring. Where a licensee supplies to both domestic and non-domestic customers, they must explain in their Trigger Point notification under SLC 4B.12 as well as their Annual Adequacy Self-Assessment (as set out from paragraph 3.37 in this Guidance) how they split assets between their domestic and non-domestic supply. This will help us understand the implications of the supplier's Trigger Point notification and to make an assessment on the appropriate response. We will continue to review the CCB notification threshold number to ensure it can achieve the intended outcome of encouraging suppliers to avoid overreliance on CCBs, and therefore this number may be subject to change. The process by which this Guidance may be amended is set out in the introduction.	*It is unclear how 'total assets' is defined in this context. This needs to be considered further and clarified in the guidance*.

Trigger	Definition	Comment
Meeting the Minimum Capital Requirement following 31 March 2025	Following the date of required compliance with the Minimum Capital Requirement of 31 March 2025, suppliers are required to notify Ofgem when they become aware of a Material risk which means they may not meet the Minimum Capital Requirement, or as soon as reasonably practicable when they no longer comply with it.	*We have no comment at present.*

Annex 3

STATUTORY CONSULTATION: STRENGTHENING FINANCIAL RESILIENCE: DRAFT LICENCE CONDITIONS SCOTTISHPOWER COMMENTS

This annex sets out comments on each of the specific draft licence conditions issued alongside the consultation document.

Reference	Comment	Suggested Amendment
SLC 30 Protecting the Renewables Obligation		
30.2 (ii) 30.3 (i) 30.5 Definition of First Demand Guarantee, RO Credit Cover Trust Account Requirements, RO Escrow Account, Standby Letter of Credit or SBLC	Reference is made to the "form" provided in the Guidance, however there is currently no form within the draft Guidance.	N/A
30.2	SLC 30.2 (iii) requires the supplier to provide a calculation of the RO Quarterly Amount, yet the definition of RO Quarterly Amount states that 'The Authority will notify Designated Electricity Suppliers of the RO Quarterly Amount in accordance with the RO Timetable.' If Ofgem is notifying suppliers of the RO Quarterly Amount, why is it necessary for them to calculate it? We wonder whether the supplier should in fact be providing a calculation of the RO Credit Cover Amount? SLC 30.2 (iii) also requires confirmation that the RO Credit Cover Mechanism(s) established by the licensee Fully Cover the RO Quarterly Amount. Again, we wonder whether the supplier	30.2 By the date specified in the RO Timetable, the Designated Electricity Supplier must provide the Authority with: i) Confirmation of the amount of electricity in MWh it has supplied to domestic customers in each Quarter; ii) A copy of the RO Credit Cover Mechanism(s) established by the licensee which must be in the form provided for in the Guidance; and iii) The licensee's calculation, which must be accurate, of the RO ~~Quarterly~~ Credit Cover Amount (provided in the definitions) including: a. supporting evidence for the calculation, including written confirmation from a Director that the RO ~~Quarterly~~ Credit Cover Amount has been accurately calculated and that the RO Credit Cover Mechanism(s) established by the licensee Fully Cover the RO ~~Quarterly~~ Credit Cover Amount;

Reference	Comment	Suggested Amendment
	should in fact be confirming that the mechanisms fully cover the RO Credit Cover Amount?	b. evidence that the licensee's RO Credit Cover Mechanism(s) Fully Cover the most recently calculated RO ~~Quarterly~~ Credit Cover Amount, including (where applicable) the most recent bank statement in relation to any RO Credit Cover Trust Account or RO Escrow Account and copies of its RO Credit Cover Mechanism(s)~~;~~.
30.3	We wonder if the references to RO Quarterly Amount should in fact be RO Credit Cover Amount?	30.3 If the licensee establishes new or supplemental RO Credit Cover Mechanism(s) to replace or supplement the RO Credit Cover Mechanism(s) previously notified to the Authority, the licensee shall (a) not terminate or allow to expire any RO Credit Cover Mechanism(s) which is to be replaced until such time as the replacement RO Credit Cover Mechanism(s) is in full force and effect and the RO ~~Quarterly~~ Credit Cover Amount Fully Covered and (b) provide the following information, in a form approved by the Authority at least 28 days prior to such new or supplemental arrangements being put in place: i) A copy of the RO Credit Cover Mechanism(s) established by the licensee which must be in the form provided for in the Guidance; ii) the portion of the RO ~~Quarterly~~ Credit Cover Amount covered by the new or supplemental RO Credit Cover Mechanism(s); and iii) confirmation that the remaining portion of the RO ~~Quarterly~~ Credit Cover Amount is covered by the licensee's existing RO Credit Cover Mechanism(s), previously notified to the Authority pursuant to paragraph 30.2; and any arrangements between the providers of the RO Credit Cover Mechanism as to the allocation of payment responsibility if the Authority takes action to enforce any such RO Credit Cover Mechanism(s).
New 30.3A	SLC 30.1 states that the supplier must “hold” the Quarterly Cumulative Obligation in the supplier account on the Register. We understand this to mean that a supplier must present the ROCs in the Register but does not need to redeem the ROCs. While we do not disagree with this, we consider it creates a risk that a supplier could withdraw and sell the ROCs without putting in place protection for the increased RO Credit Cover Amount. While the current drafting of SLC 30.3 covers situations where a supplier changes its protection mechanism, it does not cover situations where the supplier sells ROCs. We propose a new	30.3A The licensee shall not complete a sale of some or all of the ROCs held on the Register that form part of the Quarterly Cumulative Obligation, until such time as it has confirmed to the Authority that it has increased the cover under the RO Credit Cover Mechanism(s) to protect the increased RO Credit Cover amount that will result from the sale of the ROCs.

Reference	Comment	Suggested Amendment
	condition (SLC 30.3A) should be inserted to extend the requirement to cover this situation.	
30.5 Definition of “Acceptable Credit Rating”	We agree with the definition of Acceptable Credit Rating and the ratings are set at an appropriate level. However, we would suggest adding a long term debt rating threshold of A- with Standard & Poor’s (this is equivalent to A3 from Moody’s).	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, or a long term debt rating of “A1” or better.
30.5 Definition of “First Demand Guarantee”	We suggest the following modifications to the definition of First Demand Guarantee: - While we agree with the BBB threshold, we think this should be defined in a similar way to the Acceptable Credit Rating definition and explicitly state that the rating should be the long term rating of BBB or better with Standard & Poor’s or the long term rating of Baa2 or better with Moody’s. - Clause 10 should be removed as UCP 600 and ISP 98 should apply to Letters of Credit rather than First Demand Guarantees.	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 long term credit rating of at least BBB or better with Standard and Poor’s, or at least Baa2 with Moody’s, on issuance and maintained throughout until the Designated Electricity Supplier has discharged its RO in full in accordance with the RO Order and RO(S) Order, and that meets the following requirements: 1. 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; 2. it is issued in favour of the Authority as beneficiary, or in favour of any other beneficiary that the Authority shall nominate; 3. it provides for drawing rights and their proceeds expressly to be freely assignable by the Authority or the Authority's nominee; 4. it is available for drawing on demand until the Designated Electricity Supplier has discharged its RO in full in accordance with the RO Order and RO(S) Order; 5. it provides for a compliant demand to state that, by reason of the insolvency of the Designated Electricity Supplier or revocation of the Designated Electricity Supplier's licence [or a failure by the Designated Electricity Supplier to pay the RO Discharge Payment in accordance with the RO Order and / or RO(S) Order] the Authority is entitled to demand, and does demand, payment of an amount equal to, or less than, the RO Credit Cover Amount prevailing on the date of the demand and provides a form of compliant demand in an annex to the guarantee;

Reference	Comment	Suggested Amendment
		6. 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; 7. it permits partial and multiple demands that, in aggregate, do not exceed the then-current RO Credit Cover Amount; 8. [it provides for the RO Credit Cover Amount to be available for drawing throughout until the Designated Electricity Supplier has discharged its RO in accordance with the RO Order and RO(S) Order and for that amount automatically to be topped up quarterly to the full amount required to be available for drawing under this Condition]; 9. 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~~ ~~10. 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;~~ 1~~1~~0. the guarantee is in the form set out in the Guidance; and 1~~2~~1. the guarantee has been executed and delivered as a deed by the guaranteeing party.
30.5 Definition of "Fully Cover"	We wonder if the reference to RO Quarterly Amount should in fact be RO Credit Cover Amount?	**Fully Cover:** The amount payable on demand by the Authority (in aggregate) under all instruments comprising the RO Credit Cover Mechanism(s) is at least equal to the RO ~~Quarterly~~ Credit Cover Amount.
30.5 Definition of "Quarterly Cumulative Obligation"	The definition of Quarterly Cumulative Obligation refers to 'that Quarter' but it is unclear which quarter 'that' refers to. (SLC 30.1 refers to the RO Credit Cover Amount, which is defined in terms of the Quarterly Cumulative Obligation, but there is no prior mention of any quarter that the 'that' could refer to.) Given Ofgem's reference in the consultation to a 'backward-facing' obligation, we assume intention is to protect obligations relating to completed quarters (but not the current quarter) and have suggested an amendment to reflect this.	**Quarterly Cumulative Obligation:** The RO Quarterly Amount for ~~that Quarter, plus any RO Quarterly Amount for~~ any preceding Quarter or Quarters in that Obligation Period and, (except in respect of the Obligation Period immediately following the RO Effective Date) for the Quarters in the Obligation Period immediately preceding the current Obligation Period where the Designated Electricity Supplier has not yet discharged its RO in full in accordance with the RO Order and / or the RO(S) Order

Reference	Comment	Suggested Amendment
30.5 Definition of "RO Quarterly Amount"	The definition of RO Quarterly Amount appears to refer to a supplier's entire obligation in the 12 month Obligation Period. We wonder whether it should be amended to so that it refers only to the portion of the annual obligation amount attributable to the quarter in question.	**RO Quarterly Amount**: The number of ROCs that a supplier must hold ~~for that Obligation Period~~ in respect of relevant electricity supplied in a Quarter and is calculated as follows: QA = RES x LO, Where: RES means relevant electricity supplied in a Quarter which has the meaning given to it by the RO Order and the RO(S) Order respectively, but only insofar as that electricity is supplied to domestic customers; LO means level of obligation which is the number of ROCs that suppliers must redeem for each MWh of RES supplied as published in advance of the RO Obligation Period on the Ofgem website. The Authority will notify Designated Electricity Suppliers of the RO Quarterly Amount in accordance with the RO Timetable.
30.5 Definition of credit rating agencies	We note that while there is a definition provided of UCP 600 there is no definition of ISP 98, Moody's, Standard & Poor's or Fitch. Ofgem may wish to specifically define these within the licence conditions.	
SLC 4B Financial responsibility principle		
4B.7	Provide an exception for companies with an investment grade credit rating.	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, save where it holds an investment grade credit rating, 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.
4B.12	Provide an exception for companies with an investment grade credit rating	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, save where it holds an investment grade credit rating, 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, save where it holds an investment grade credit rating, that any of the Trigger Points have occurred.
4B.15	We think there is an incorrect reference and 4B.16 should read as 4B.19 (although as we note below, we think there are some typos within the drafting that would create renumbering).	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.1~~6~~9.
4B.17 to 4B.19	We think there are some formatting issues that need amended. In particular:	4B.16 The Guidance will make provision for:

Reference	Comment	Suggested Amendment
	- We think the current 4B.17 should be part of 4B.16 rather than a separate clause - We think the bullet points in 4B.18 and 4B.19 should start at a) rather than continue from those in the current 4B.17 We consider Ofgem must allow for a longer period of review for any amendments to the Guidance, however notwithstanding this, Ofgem's current drafting is inconsistent with the Guidance as it states, "10 days" rather than "10 working days".	~~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.1~~8~~7 Before issuing the Guidance document by direction, the Authority will publish on the Authority's website: ~~d.~~ a. the text of the proposed Guidance; ~~e.~~ b. the date on which the Authority intends the Guidance document to come into effect; and ~~f.~~ c. a period of not less than ~~10 days~~ four weeks during which representations may be made on the content of the Guidance. 4B.1~~9~~8 Before amending the Guidance document, the Authority will publish on the Authority's website: ~~g.~~ a. The proposed text of the new or amended Guidance document; ~~h.~~ b. the date on which the Authority intends the new or amended Guidance document to come into effect; ~~i.~~ c. the reasons for the amendments to the Guidance document; and ~~j.~~ d. a period of not less than ~~10 days~~ four weeks during which representations may be made on the amendments to the Guidance document.
4B.20	Include definition of investment grade credit rating	Investment Grade Credit Rating means a rating of Baa3 or better by Moody's (or its equivalent under any successor rating categories of Moody's); a rating of BBB- or better by Standard and Poor's (or its equivalent under any successor rating categories of Standard and Poor's); and the equivalent investment grade credit rating from any additional Rating Agency or Rating Agencies selected by Ofgem.
4B.20 Definition of 2025 Minimum Capital Requirement	We think the correct reference for the new Minimum Capital Requirement licence condition should be SLC 4B.4 and not 4B.6.	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~~4] and in

Reference	Comment	Suggested Amendment
		respect of new market entrants within 28 days of the grant of the [gas/electricity] supply licence and meets the Alternative Source Conditions.
4B.20 Definition of Alternative Source Conditions	We think Ofgem should include explicitly the minimum requirements for Moody's as well as that for Standard and Poor's.	the third party must have, and maintain, long term credit rating of not less than BBB by Standard and Poor's or Baa2 with Moody's, or XXX with Fitch Ratings.
4B.20 Definition of Domestic Premises	We note that Ofgem is introducing a separate definition of Domestic Premises to that already included within SLC 1. While on this review we cannot see that the inclusion of this separate definition creates any different interpretation, we consider it poor regulatory practice to have multiple definitions of the same term within different parts of the licence conditions and would suggest this is deleted as it is not needed alongside the existing SLC 1 definition or reference is made to the existing definition.	Domestic Premises ~~Means premises at which a supply is taken wholly or mainly for domestic purposes~~ has the meaning given to it in Standard Condition 1
SLC 4D Protecting Domestic Customer Credit Balances		
4D.3	Ofgem references the "Consumer Credit Balance Guidance" however as far as we can gather from the documents already published as part of this review, the guidance relating to SLC 4D is intended to form part of the revised Guidance on the Financial Responsibility Principle rather than being provided as a separate guidance document. Ofgem should clarify in the final licence conditions the correct document for the guidance relating to SLC 4D.	N/A
4D.3 4D.10 Definition of Credit Balance Escrow Account, Credit Balance Trust Requirements, Standby Letter of Credit or SBLC	Reference is made to the "form" provided in the Guidance, however there is currently no form within the draft Guidance.	N/A

Reference	Comment	Suggested Amendment
4D.10 Definition of First Demand Guarantee	We suggest the following modifications to the definition of First Demand Guarantee: - While we agree with the BBB threshold, we think this should be defined in a similar way to the Acceptable Credit Rating definition and explicitly state that the rating should be the long term rating of BBB or better with Standard & Poor's or the long term rating of Baa2 or better with Moody's. - Clause j) should be removed as UCP 600 and ISP 98 should apply to Letters of Credit rather than First Demand Guarantees	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 long term credit rating of - at least BBB or better with Standard and Poor's, or at least Baa2 with Moody's 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

Reference	Comment	Suggested Amendment
		~~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~~j) the guarantee has been executed and delivered as a deed by the guaranteeing party.

ScottishPower
January 2023