

To: All holders of a gas supply licence

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

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

1. The Gas and Electricity Markets Authority ('the Authority')¹ proposes to modify the standard conditions of all gas supply licences granted or treated as granted under 7(A) of the Gas Act 1986 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 accompanying this notice.
2. We are proposing these modifications because, following an earlier statutory consultation in November 2022, we have received a wide range of views on our proposals to introduce a minimum capital requirement (and the power to direct ringfencing of Customer Credit Balances (CCBs), addressed in a separate notice accompanying this) and have decided to seek further input through a supplemental statutory consultation to clarify our proposals and refine the policy design and licence drafting. We believe that setting a common minimum capital requirement for all domestic suppliers and introducing powers to direct ringfencing of CCBs will address the some of the systemic challenges in the retail energy market that led to high levels of supplier failure and high mutualised costs for consumers.
3. Further detail as to why the Authority proposes to make these licence modifications has been published by the Authority in the statutory consultation accompanying this notice.
4. We are proposing modifications that require suppliers to maintain a Capital Floor of the equivalent to £0 Adjusted Net Assets per domestic dual fuel customer from 31 March 2025 and meet a Capital Target equivalent to £130 Adjusted Net Assets per domestic dual fuel customer (i.e., £65 per domestic gas customer and £65 per domestic electricity customer) from 31 March 2025. We propose that suppliers not meeting the Capital Floor would be in breach of the licence condition. Suppliers which are below the Capital Target but above the Capital Floor are in the Intermediate Position and are subject to Transition Controls until they have a Capitalisation Plan approved by the Authority. The Capitalisation Plan will set out how the supplier intends to meet the Capital Target and the supplier must report on progress every quarter. We are seeking views on the compliance framework, the level of the Capital Floor and Capital Target and the definition of Capital in the statutory consultation accompanying this notice.
5. Taken together with the decision published alongside this notice to modify SLC 4B (the Financial Responsibility Principle) and introduce SLC 30 (ringfencing of Renewable Obligation receipts), as well as the notice to propose introducing a new SLC 4D (Protecting Domestic Customer Credit Balances), the effect of these proposed modifications is to help deliver a retail energy market that is secure, sustainable, and therefore able to deliver the innovation and positive consumer outcomes needed in the future.

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

6. A copy of the proposed modifications and other documents referred to in this Notice have been published on our website (www.ofgem.gov.uk). Alternatively, they are available from foi@ofgem.gov.uk.
7. Any representations with respect to the proposed licence modification/modifications must be made on or before 5 May 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.
8. 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.
9. If we decide to make the proposed modifications, they will take effect not less than 56 days after the decision is published.



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

5 April 2023

Schedule 1: Draft of proposed modifications to the standard conditions of all gas supply licences

We have included the SLC 4B below and the changes we propose to make. Deletions are shown in strike through and new text is underlined. Blue highlight is for standard conditions that are subject to the 56 day standstill period post decision.

Annual Adequacy Self-Assessment

- 4B.11 The Annual Adequacy Self-Assessment must set out the how the licensee:
- a. has complied with standard conditions 4B.1, 4B.2, 4B.3, 4B.4, 4B.5 and 4B.6 and 4B.16 over the previous 12 calendar months; and
 - b. intends to comply with standard conditions 4B.1, 4B.2, 4B.3, 4B.4, 4B.5 and 4B.6 and 4B.16 for the next 12 consecutive calendar months;
 - c. has met the Capital Target or has complied with standard condition 4B.18 and 4B.19 over the previous 12 calendar months; and
 - d. intends to meet the Capital Target or intends to comply with standard condition 4B.18 and 4B.19 over the next 12 consecutive calendar months.

Capital Floor and Capital Target

4B.16 If the licensee supplies to Domestic Premises, with effect from 31 March 2025, the licensee's Adjusted Net Assets must not be below the Capital Floor.

4B.17 The licensee must, with effect from 31 March 2025, notify the Authority in writing as soon as reasonably practicable, and not more than 7 days, after it becomes aware that its Adjusted Net Assets are below the Capital Floor or there is a Material risk that its Adjusted Net Assets will be below the Capital Floor.

4B.18 If the licensee supplies to Domestic Premises, with effect from 31 March 2025, where the licensee's Adjusted Net Assets exceed the Capital Floor but are below the Capital Target (the "Intermediate Position"), it must:

- i) Notify the Authority, as soon as reasonably practicable, and at most within 7 days, of being in the Intermediate Position, that it is in the Intermediate Position;
- ii) Notify the Authority at least 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 to consumers (with such payments and transactions together hereinafter referred to as "Non-essential Payments");
- iii) Adhere to Transition Controls until the Capitalisation Plan has been approved by the Authority in accordance with standard condition 4B.19 ("Approved Capitalisation Plan"); and
- iv) Once the Capitalisation Plan has been so approved, adhere to the Approved Capitalisation Plan.

4B.19 Where the licensee is in the Intermediate Position:

- i) It must submit to the Authority a credible proposed Capitalisation Plan (the "Proposed Capitalisation Plan").
- ii) The Authority will consider the Proposed Capitalisation plan and confirm in writing to the licensee whether it is has been approved or rejected.
- iii) Where the Authority approves the Proposed Capitalisation Plan the licensee must adhere to the Approved Capitalisation Plan in accordance with 4B.18(iv).
- iv) Where the Authority rejects the Proposed Capitalisation Plan, it will provide the licensee with reasons for its rejection. In those circumstances, the licensee must

submit to the Authority a further Proposed Capitalisation Plan which the Authority will consider and either approve or reject with reasons.

4B.20 Where the licensee seeks to amend the Approved Capitalisation Plan:

- i) It must notify the Authority of the amendment(s) it proposes and the reasons for proposing the amendment(s) at least 28 days before the next Quarterly Progress Milestone.
- ii) After receiving notification, the Authority will consider, and either accept or reject, the proposed amendment(s). For the avoidance of doubt, the Authority will only accept the proposed amendment(s) where the licensee satisfies it that there is reason to do so.
- iii) If the Authority accepts the proposed amendment(s), the licensee must adhere to the amended Approved Capitalisation Plan.
- iv) If the Authority rejects the proposed amendment(s), it will provide the licensee with reasons for its rejection. Upon receiving notification from the Authority of rejection, the licensee will then have a further 14 days during which representations may be made on the Authority's decision to reject the proposed amendment(s).
- v) If, following any representations from the licensee, the Authority accepts the proposed amendment(s), the licensee must adhere to the amended Approved Capitalisation Plan.
- vi) If, following any representations from the licensee, the proposed amendment(s) are rejected, the licensee must continue to adhere to the (unamended) Approved Capitalisation Plan.

4B.21 Where the Authority seeks to amend the Approved Capitalisation Plan:

- (i) It must notify the licensee of the amendment(s) to the Approved Capitalisation Plan it proposes and the reasons for proposing the amendment(s) at least 28 days before the next Quarterly Progress Milestone.
- (ii) After receiving notification, the licensee will have 14 days to consider the proposed amendment(s) and a further 14 days during which representations may be made on the proposed amendment(s).
- (iii) If, following any representations from the licensee, the Authority continues to proceed with amendment(s) to the Capitalisation Plan that it has proposed, the licensee must adhere to the amended Approved Capitalisation Plan.
- (iv) If, following any representations from the licensee, the Authority decides not to proceed with the amendment(s) to the Approved Capitalisation Plan that it has proposed, the licensee must continue to adhere to the original Approved Capitalisation Plan.

Circumstances for directing ringfencing of Customer Credit Balances

4B.22 The Authority will 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, or any other relevant data that the Authority receives or obtains indicates that:

- i) The licensee does not have Cash equal to or greater than 20% of Domestic Customer Credit Balances (the "Cash Coverage Trigger"); or
- ii) From 31 March 2025 onwards, the licensee's Adjusted Net Assets are below the Capital Target (the "Capital Target Trigger"); or

- iii) There is a Material risk that, within the next 12-month period the licensee will hit the Cash Coverage Trigger or the Capital Target Trigger

except in circumstances where the licensee satisfies the Authority, in accordance with standard condition 4B.23, that Protecting Domestic Customer Credit Balances in accordance with standard condition 4D would not be in the Consumer Interest (the "Consumer Interest Test").

4B.23 Before a direction is issued by the Authority in accordance with standard condition 4B.22:

- i) The Authority must notify the licensee that it is minded to issue a direction in accordance with standard condition 4B.22;
- ii) After receiving such notification from the Authority, the licensee will have 7 working days within which to make representations to the Authority on the Consumer Interest Test.

4B.24 Where the Authority issues a direction under standard condition 4B.22 the licensee must apply an Adjustment Percentage of 100% for the purposes of standard condition 4D.4 unless, in its review of 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, the Authority considers that an Adjustment Percentage of 100% will have a Material adverse effect on the licensee's ability to finance its activities and in such a case the Authority will direct an Adjustment Percentage of less than a 100% but which ensures that the licensee has sufficient Working Capital to pay its employees and those suppliers whose goods or services are essential to the continued operation of its supply business and other essential monetary obligations (such as, but not limited to, meeting its tax liabilities).

4B.25 The Authority will revoke a direction issued under standard condition 4B.22 where it is satisfied that the circumstances for issuing a direction under standard condition 4B.22 are no longer present.

Guidance

4B.16 4B.26 The licensee must have regard to the Guidance issued on standard condition 4B which, following consultation, the Authority may issue and may from time to time revise.

4B.17 4B.27 Definitions:

Adjusted Net Assets

Means Net Assets (fixed assets + current assets) – (current liabilities – non-current liabilities) as measured according to suppliers' internal accounting standards (e.g. IFRS or UK GAAP) and reported in suppliers' Financial Statements plus any Alternative Source of Capital that has been approved by the Authority.

Requests to utilise Alternative Sources of Capital to meet the Capital Floor or Capital Target must be notified to the Authority in writing no later than 24 weeks before the date provided for in standard condition 4B.16 and in respect of new market

entrants within 28 days of the grant of the gas supply licence

Adjustment Percentage

Means the % the Authority directs in accordance with standard condition 4B.24

Alternative Sources of Capital

Means:

- Unsecured shareholder loans, not subject to accelerated repayment conditions, with a minimum 12-month residual maturity
- Drawn Parent / Group Company Working Capital Facilities from a counterparty with a minimum credit rating of Baa3/BBB- or equivalent, with a minimum 12-month residual maturity and not be subject to full repayment and/or cancellation.
- Undrawn Parent / Group Company Working Capital Facilities from a counterparty with a minimum credit rating of Baa3/BBB- or equivalent, with a minimum 12-month residual maturity and repayment profile provided that it is not subject to cancellation and/or drawstop conditions.
- Unconditional, quantifiable general guarantee from a related party with a minimum credit rating of Baa3/BBB-, with a minimum 12-month residual tenor.

Capitalisation Plan

Means a credible plan submitted by the licensee and accepted by the Authority in accordance with SLC 4B.19. The plan must, at a minimum, include the following:

- The cause for the licensee being below the Capital Target
- The level of funds needed to meet the Capital Target
- How they intend to raise further funds
- How they intend to conserve existing funds, including limiting Non-essential Payments
- Whether core business functions will be affected

- The timeframe it would take to recover
- Assumptions on customer growth and relevant commercial strategy
- Risks to recovering within the proposed timeframe
- The governance arrangements, including who is responsible for taking relevant decisions
- Quarterly Progress Deadline Milestones

Capital Floor

Means licensee Adjusted Net Assets of £0 per Domestic Customer.

Capital Target

Means licensee Adjusted Net Assets of £65 per Domestic Customer

Cash

Means the total amount of money held at the bank by licensee in current or deposit accounts and which is included in the balance sheet under current assets.

Consumer Interest

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

Domestic Customer Credit Balance

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

Fixed Direct Debit

Means an instruction from the customer to their bank or building society that authorises an organisation to collect a fixed amount from the customer's account at regular intervals, provided that advance notice of

the amount and the dates of collection have been provided.

Low-Cost Transition to Net Zero

Means the ability of gas 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)

Prices

Means Charges for the Supply of Gas

Protect

Means to put in place and maintain in effect a Credit Cover Support Arrangement in respect of the Protected Amount that protects that sum of money in the event of the licensee's insolvency or licence revocation. "Protecting" and "Protection" shall be construed accordingly.

Protected Amount

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

Quality and Standards

Means the extent of competition, innovation and level of customer service in the market

Quarterly Progress Milestone

Means the agreed quarterly deadline for the licensee to report to the Authority on: (i) the progress made towards achieving the Approved Capitalisation Plan; and (ii) in circumstances where the Capital Target Trigger has occurred and the Authority has not issued a direction under standard condition 4B.8, whether and why Protecting Customer Credit Balances in accordance with SLC 4D is or is not in the Consumer Interest]

Resilience

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.

Supervisory Financial Monitoring

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.

Transition Controls

Means the controls in place where the licensee is in Intermediate Position but before there is an Approved Capitalisation Plan in place. These controls are that the licensee must:

- refrain from all sales, marketing and customer acquisition activity, including the acquisition of any new domestic customers or upgrading of all existing domestic customer to dual fuel ("Sales Ban")
- refrain from making any payment, providing any loan or transferring any asset to any third party unless that payment, loan or transfer is one that: i) is required to make by virtue of a legal requirement; ii) is essential to the licensee's operation as a supplier of gas to consumers; or iii) is otherwise approved in writing by the Authority ("Non-essential Payments Ban").

Working Capital

Means the capital used to cover differences between when goods and services are paid for by suppliers, and when customers pay their bills. This can also be considered as the net current assets/liabilities of a supplier.