Modification proposal:	**Distribution Connection and Use of System Agreement (DCUSA) DCP413 – 'Value of a User's Credit in Schedule 1' (DCP413)**		
Decision:	The Authority[1] has decided to reject[2] this modification[3]		
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested parties		
Date of publication:	23 October 2023	Implementation date:	Not applicable

Background

Currently Independent Credit Assessments are converted into a Credit Allowance Factor (CAF). This conversion can result in disproportionately high credit allowances. An Independent Credit Assessment can result in a supplier being afforded £m's worth of credit when the Credit Assessment Factor is applied. This credit is also available for each distribution services area that a particular supplier trades in.

The proposer of the change argues that Once the Credit Allowance Factor is applied the Credit Allowance bears no resemblance to the outcome of an Independent Credit Assessment carried out by a Recognised Credit Assessment Agency. Consequently this risk needs to be reduced.

This issue was considered in the original draft of a previous change to the electricity codes - DCP 349 'Effectiveness of the current provision of unsecured cover under

[1] References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

[2] This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

[3] 'Change' and 'modification' are used interchangeably in this document.

Schedule 1', but the working group agreed to remove this element as the risk at the time was predominantly associated with Good Payment History, i.e. timely payment of bills[4]

The proposal was introduced as industry has seen many businesses fail. The proposer noted that when firms do fail their costs are socialised, with consumers facing this cost, and given the high inflationary environment, with energy costs being a core component, consumers need to be protected.

The modification proposal

The proposed modification (the Proposal), raised by Electricity North West, would adopt one of the principles of the Uniform Network Codes[5]. The clause being:

"The Transporter will set the User's Unsecured Credit Limit no higher than the lower of the credit value recommended within the Independent Assessment and the value calculated by applying the Independent Assessment Score to the Transporter's Maximum Unsecured Credit Limit."

The change proposal seeks to delete the table within schedule 1 where the independent credit assessment is assigned a CAF value and replace it with reference to the level of credit described within the independent credit assessment.

By utilising independent credit assessments, the proposal seeks to better reflect the relationship between available credit and underlying risk. A similar approach is already in use in the gas market, since 2010. [6]

DCUSA Parties' recommendation

In each party category where votes were cast (no votes were cast in the DG party category for gas suppliers),[7] there was majority (>50%) against for the proposal and split for its proposed implementation date. In accordance with the weighted vote procedure, the recommendation to the Authority is that DCP413 is rejected. The outcome of the weighted vote is set out in the table below:

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[4] Effectiveness of the current provision of unsecured cover under Schedule 1 - DCUSA.

[5] competitive gas industry's legal and contractual framework for the transportation and supply of gas

[6] 0305 - RG0252 Proposal 8 Unsecured Credit Limit allocated through payment history | Joint Office of Gas Transporters (gasgovernance.co.uk) .

[7] There are currently no gas supplier parties.

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DCP413	WEIGHTED VOTING (%)							
	DNO[8]		IDNO/OTSO[9]		SUPPLIER		CVA[10] REGISTRANT	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	46%	54%	None Received	None Received	0%	100%	None Received	None Received
IMPLEMENTATION DATE	72%	28%	None Received	None Received	0%	100%	None Received	None Received

Our decision

We have considered the issues raised by the change proposal, the Change Declaration and Change Report dated 27 September 2022. We have considered the vote of the DCUSA Parties on the proposal which is attached to the Change Declaration. We have concluded that:

- the implementation of the modification proposal will not better facilitate the achievement of the Applicable DCUSA objectives.[11]

Reasons for our decision

OFGEM agrees with the DCP413 Workgroup's assessment of DCP413 using the DCUSA objectives, namely that DCP413:

- negatively impacts DCUSA Objective 2,
- facilitates DCUSA Objectives 3 and 4, and
- has a neutral impact on DCUSA Objectives 1 and 5.

[8] Distribution Network Operator

[9] Independent Distribution Network Operator/Offshore Transmission System Operator

[10] Central Volume Allocation

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

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OFGEM agrees with the DCP413 Workgroup that there will likely be a significant impact from the proposed change "as it is likely to have a significant impact on the interests of electricity consumers and on competition in the supply of electricity."[12] OFGEM does not agree that these changes would be net positive.

OFGEM notes the Workgroup's view that the Proposal positively impacts Objectives 3 & 4. However, on balance our view is that the negative impact on Objective 2 outweighs the positive impact brought about by Objectives 3 & 4. OFGEM believes that the impact would be large and affect firms in different and unpredictable ways. We consider there to be insufficient evidence and analysis to know the full impact of this change.

Participants in the DCP413 Workgroup highlighted the heterogenous impacts that could be brought about through using different credit rating agencies. In particular, small and medium sized companies could be put at a disadvantage.

With the impact being concentrated on certain types of companies the breadth of the market could be reduced, if companies exit, leading to less consumer choice.

With more energy companies exiting the market would tend to lead the remaining firms increasing their market share, thus reducing the incentives for competition. Decreased suppliers would lead to less competition, and higher prices for consumers. Energy companies exiting the market would also lead to socialised costs as consumers have in the past had to pay additional costs in their energy bills when energy companies have gone into administration.

In the absence of an evidence base to predict where these impacts would fall, OFGEM would not be in a position to plan contingencies for these outcomes.

Applicable DCUSA Objective (2)– the facilitation of effective competition in the generation and supply of electricity and (so far as is consistent with that) the promotion of such competition in the sale, distribution and purchase of electricity

[12] DCUSA change declaration – DCP413 Value of User's Credit Allowance in Scheule 1

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Respondents from industry consultees highlighted the risk of suppliers having significant changes to the amount of capital available to them. An anonymous source in the working group showed that the amount of funding available to some energy companies would be reduced by up to a factor of 20. This raises the potential of high market exits and may lead to the consequential higher costs falling onto consumers.

OFGEM believes that this objective is not supported by such a change and that evidence to the contrary is not currently available.

Applicable DCUSA Objective (3) - the efficient discharge by the licensee of the obligations imposed upon it by its licence

Members of the working group felt that this objective was better facilitated by the change as credit would be more reflective of risk. OFGEM agrees with this assessment but overall considers that the negative impact on Objective 2 outweighs the positive impact of this Objective.

Applicable DCUSA Objective (4) – the promotion of efficiency in the implementation and administration of the DCUSA arrangements

The DCP413 Workgroup felt that this objective was better facilitated by the change as credit would be more reflective of risk. OFGEM agrees with this assessment but overall considers that the negative impact on Objective 2 outweighs the positive impact of Objective 4.

Decision notice

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority hereby directs that modification proposal DCP413: 'Value of a User's Credit in Schedule 1 ' not be made.

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Melissa Giordano

Deputy Director Retail Systems and Processes

Signed on behalf of the Authority and authorised for that purpose

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