

Proposed variation:	<b>Distribution Connection and Use of System Agreement (DCUSA) DCP034: Credit cover arrangements for small suppliers</b>		
Decision:	The Authority <sup>1</sup> directs that this proposed variation be made		
Target audience:	Parties to the DCUSA and other interested parties		
Date of publication:	24 February 2009	Implementation Date:	26 February 2009

## Background to the proposed variation

Schedule 12 of the DCUSA sets out matters of future development to be undertaken by the DCUSA Panel and DCUSA Parties. At its meeting in February 2008 the Panel added each of these items to its work plan and agreed to commence work on the List of Registered Credit Assessment Agencies (LORCAA) Project. The Panel therefore established the LORCAA Project Group. The Terms of Reference for the group required it to review and develop the arrangements for obtaining the Credit Assessment Score from an Approved Credit Referencing Agency. This is used to determine the Credit Assessment Factor (CAF) for parties, typically small suppliers, who do not currently have a minimum credit rating of Ba3/BB- or above.

The CAF is used in combination with the Regulatory Asset Value (RAV) of the company providing credit to determine a Users Credit Allowance, using the following formula, as set out in Schedule 1 of the DCUSA:

$$CA = RAV \times 2\% \times CAF$$

The report from the LORCAA Project Group was submitted to and accepted by the Panel on 16 July 2008.

## The proposed variation

DCUSA Change Proposal 034 (DCP034) was raised by the independent distribution network operator, Electricity Network Company on behalf of the LORCAA group and seeks to incorporate the recommendations of the group. In summary, DCP034 seeks to:

- Place within Schedule 1 of the DCUSA a list of credit scores used by different credit agencies and identify their equivalence to a Credit Assessment Score, and
- Make provisions to allow Users to request a distributor to procure a report from a recognised credit assessment agency that is either of a type not listed in that Schedule, or from a registered credit assessment agency that is not listed.

The proposals therefore sets out the mechanics of how the various rating agency figures translate into CAF, i.e. that Experian's '95-100' rating is the equivalent of the Equifax's 'A+' rating, and these both give a DCUSA Credit Asset Score of 10. In accordance with the existing table at paragraph 2.12 of Schedule 1, this would equate to a CAF of 20%. An unrated small party could therefore obtain unsecured credit up to the equivalent of a company rated as BBB+ by Standard and Poor. Whilst all of this was possible prior to

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

this proposal, nothing was agreed as to how the credit assessment agency reports would translate into CAF. There was therefore uncertainty of how the process would work, and the potential for each DNO/IDNO to establish their own, and potentially differing arrangements. This proposal therefore clarifies and standardises the arrangements.

The proposal also seeks to address a minor error in the definition of RAV, which is currently defined as being the figure in the latest audited price control information. As price control information is not audited on a year to year basis, the proposal seeks to remove the word "audit" from the definition. The existing requirement to provide an independent credit report within a month has also been amended to "as soon as reasonably practicable" in recognition that certain types of report may take longer than one month to secure.

The proposer considers that the implementation of this proposal will better facilitate applicable objectives b) and c) of the DCUSA.

### **DCUSA Panel Recommendation**

The DCUSA Panel approved the DCP034 Change Report on 17 December 2008 and recommended to the Authority that DCP034 be implemented, having noted that the proposal received support from more than 50% of weighted votes in all voting categories. The Panel considered that the implementation of DCO034 will better facilitate Objectives (b) and (c) of the DCUSA.<sup>2</sup> The Panel also recommended that an implementation as part of the 26 February 2009 scheduled DCUSA release would be beneficial, but noted that this was dependent upon the timescales of the Authority's decision.

### **The Authority's decision**

The Authority has carefully considered the issues raised by DCP032 and the final Change Declaration dated 20 January 2009. The Authority has also carefully considered and taken into account the responses to ElectraLink's<sup>3</sup> consultation which are attached to the Change Declaration<sup>4</sup> and the recommendation of the DCUSA Parties. The Authority has concluded that:

1. implementation of the proposed variation will better facilitate the achievement of the Applicable DCUSA Objectives<sup>5</sup>; and
2. directing that the proposed variation be made is consistent with the Authority's principal objective and statutory duties<sup>6</sup>.

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<sup>2</sup> The DCUSA Applicable Objectives are:

- Objective (a) – the development, maintenance and operation by the licensee of an efficient, co-ordinated, and economical Distribution System;
- Objective (b) - the facilitation of effective competition in the generation and supply of electricity and (so far as is consistent with that) the promotion of such competition in the sale, distribution, and purchase of electricity;
- Objective (c) - The efficient discharge by the licensee of the obligations imposed upon it by this licence; and
- Objective (d) - The promotion of efficiency in the implementation and administration of the DCUSA arrangements.

<sup>3</sup> The role, functions, and responsibilities of Electralink are set out in Section 1B of the DCUSA.

<sup>4</sup> DCUSA change proposals, modification reports and representations can be viewed on the DCUSA website at <http://dcusa.co.uk/Public/Default.aspx>

<sup>5</sup> As set out in the Distribution Licence Standard Condition 22.2 (version 1 October 2008) see: [http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=12773](http://epr.ofgem.gov.uk/document_fetch.php?documentid=12773)

<sup>6</sup> The Authority's statutory duties are wider than matters which the Panel must take into consideration and

## Reasons for the Authority's decision

We note and are encouraged that this proposal attracted widespread support from all DCUSA constituencies, including responses from several smaller parties.

Whilst the majority of respondents were in favour of the proposal there were few substantive comments provided. In the comments made, a common theme was that this proposal would improve the transparency and clarity of the credit assessment arrangements for those parties who do not currently have a credit rating. We agree with these comments.

## Consideration of DCP034 under the Applicable DCUSA Objectives

We also agree that this proposal will improve the transparency of the credit arrangements and should expedite the process by which small suppliers with no credit rating may obtain unsecured credit, particularly through reducing the scope for dispute on the basis of the assessment, and the potential for inconsistent approaches from the various DNO/IDNOs. This should result in reduced costs to suppliers and can therefore be expected to further applicable objective b) *the facilitation of effective competition in the generation and supply of electricity and (so far as consistent therewith) the promotion of such competition in the sale, distribution and purchase of electricity.*

Whilst we do not disagree with the proposer that this DCP034 could better facilitate applicable objective c) *the efficient discharge by the licensee of the obligations imposed upon it by this licence*, we consider that the stated efficiency benefits of managing the information on credit arrangements in a single source (i.e the DCUSA) will be marginal. They may also be more relevant to applicable objective d) *the promotion of efficiency in the implementation and administration of the DCUSA arrangements.*

One respondent was opposed to the implementation of the proposal on the basis that the various credit assessment agencies may not provide entirely consistent assessments. They felt that the assessment scores proposed in DCP034 do not provide consistent and worthwhile safeguards to the DNOs. We agree that there is potential for differences in the assessment of Users' credit worthiness that various agencies may provide, though that is essentially why a range of potential providers is so important, allowing the User the opportunity to gain what is in effect a second opinion if they disagree with an initial assessment. The fact that these must be recognised agencies should provide the DNO/IDNO with a degree of comfort that the assessment is reasonable, even if it does differ from another. This potential for discrepancies may also occur where the agency provides more than one assessment product. Again, the User has discretion to select which product, in their reasonable opinion, provides a more appropriate assessment of their creditworthiness. However, no respondents raised concerns with this element of the proposal.

Another respondent, while supporting much of the proposal, suggested that it may be difficult to agree with a User what product will give the most appropriate assessment of creditworthiness. Our understanding is that this potential for disagreement can only occur where the User wishes to use an agency or product which is not already considered acceptable by definition of it being listed in Paragraph 2.8 of Schedule 1 (DCP034-Legal Drafting) to the DCUSA Change Report dated 15 December 2008.. In these cases it may

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are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation.

indeed be reasonable for the DNO/IDNO to dispute that choice and seek to resolve that dispute in line with the Dispute procedure set out in Paragraph 8 of Schedule 1.

### **Ofgem's further thoughts**

We agree with the respondent who suggested that it would be appropriate to conduct a holistic review of the credit cover arrangements. It is now four years since Ofgem published its *Best practice guidelines for gas and electricity network operator credit cover* document<sup>7</sup>, and the economic climate has obviously changed significantly in that time, particularly with respect to the availability and cost of finance.

### **Decision notice**

In accordance with Standard Condition 22.2 of the Distribution Licence, the Authority hereby directs that the proposed variation set out in DCP034: '*Credit cover arrangements for small suppliers*' be made.

A handwritten signature in black ink, appearing to read 'Rachel Fletcher', is centered on the page. The signature is written in a cursive style.

**Rachel Fletcher**  
**Director, Distribution**

Signed on behalf of the Authority and authorised for that purpose.

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<sup>7</sup> <http://www.ofgem.gov.uk/Licensing/IndCodes/CreditCover/Documents1/9791-5805.pdf>