

Modification proposal:	Smart Energy Code (SEC) Modification Proposal (MP 159): 'Credit Cover Review'		
Decision:	The Authority ¹ determines that this modification ² should be made.		
Target audience:	Data and Communications Company (DCC), SEC Panel, Parties to the SEC and other interested parties		
Date of publication:	29 April 2022	Implementation date:	30 June 2022

Background

Smart Energy Code (SEC) Parties that incur Data and Communications Company (DCC) charges are required to put in place a form of Credit Cover which would cover their obligations to the DCC in the event of the Party not meeting their financial obligations. The SEC outlines the Credit Cover requirements and processes; however, the language within the code has been found to be overly complex and SEC Parties have indicated support for a clearer explanation of the requirements and processes to avoid misinterpretation.

The DCC calculates the Credit Cover Requirement to be the Party's Value at Risk less their Unsecured Credit Limit. It is updated by the DCC on at least a weekly basis. Credit Cover will pay for a Party's outstanding debts up to the value of the Credit Cover. This can be provided by a Party through a bank guarantee, letter of credit or cash deposit. A Party without Credit Cover that does not meet its obligations will have their unpaid DCC charges socialised to SEC Parties.³

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 'Change' and modification are used interchangeably in this document.

³ Credit Cover and support arrangements are outlined in Section J 'Charges' of the SEC.
<https://smartenergycodecompany.co.uk/download/2494>

The modification proposal

On 13 April 2021, the DCC (the Proposer), raised SECMP159: Credit Cover Review. The proposal seeks to clarify SEC Section J 'Credit Cover'⁴ by re-drafting certain clauses within this section in plain English. This, the Proposer asserts, will help to mitigate the risk of misinterpretation of these obligations by SEC Parties, the SEC Panel or the DCC. The Proposer has indicated that the review will also focus on addressing other inefficiencies within the legal drafting. It is noted that the re-drafting will not change any of the requirements as set out within the SEC, but by simplifying the language used in the SEC, it will remove opportunities for misinterpretation which in turn reduces the risk of SEC Parties being exposed to potential cost socialisations in the future.

The Proposer explains that the complexity of the wording in Section J has led to SEC Parties and the DCC interpreting requirements related to Credit Cover differently. This has resulted in previous misunderstandings between SEC Parties and the DCC resulting in the incorrect level of Credit Cover being calculated and provided. Additionally, further inefficiencies have been identified such as the DCC's previous interpretation that a Parent Company Guarantee (PCG) equated to a letter of credit. The solution being proposed is to re-draft portions of the text related to Credit Cover arrangements within the SEC.

SEC Section M 'General' will also be amended to update the confidentiality provisions to facilitate expedient sharing of SEC Party information with the SEC Panel. The amendments to Section J will clarify the following:

- The calculation of Credit Cover Requirement being calculated at least monthly instead of weekly.
- Explicit Charges will be excluded from the Value at Risk calculation.
- PCGs cannot be used as a form of Credit Cover.
- The requirement to obtain a Recognised Credit Rating from Dominion Bond Rating Service will be removed.

⁴ Smart Energy Code (SEC) Section J – Charges <https://smartenergycodecompany.co.uk/download/2494>

- Credit Assessment Scores will be obtained monthly rather than annually to reduce the risk of a SEC Party having an inadequate level of Credit Cover.
- Only one Credit Assessment Agency will be used for all SEC Parties for consistency.
- If a Party's level of Credit Cover is less than what has been calculated for that month by more than £100, the Party will have two working days to provide additional funds.
- The SEC will be updated to extend the current period whereby the DCC can draw down on Credit Cover following an unpaid invoice from one working day to five working days.
- The DCC will send an informal reminder to a SEC Party the month before its letter of credit or bank guarantee is set to expire.

The updated legal text is included within Annex A of the Final Modification Report.⁵

SEC Change Board⁶ recommendation

On 24 March 2022, the Change Board considered that SEC Modification Proposal MP159: 'Credit Cover Review' would better facilitate SEC Objectives, namely the second, fourth and seventh General SEC Objectives. The Change Board unanimously recommended its approval.

Our decision

We have considered the issues raised by the proposal. We have also taken into account the votes of the SEC Change Board as set out in the Final Modification Report⁷ dated 24 March 2022. We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of SEC objectives, and
- directing that the change approved is consistent with the Authority's principal objective and statutory duties.⁸

⁵ MP159 Modification Report 1.0 <https://smartenergycodecompany.co.uk/download/32687>

⁶ The SEC Panel and Change Board are established and constituted pursuant to and in accordance with DCC Licence 22.26(a).

⁷ MP159 Conclusions Report <https://smartenergycodecompany.co.uk/download/40579>

⁸ The Authority's statutory duties are wider than matters that the Panel must take into consideration and are detailed mainly in the Electricity Act 1989 as amended and the Gas Act 1986 as amended.

Reasons for our decision

We consider that this modification proposal will better facilitate the second, fourth, and seventh General SEC Objectives, and will have a neutral impact against the other SEC Objectives.

The second General SEC Objective is to enable the Licensee to comply at all times with the General Objective of the Licensee, and to efficiently discharge the other obligations imposed upon it by this Licence.

The Proposer asserts, and we agree that this Objective will be better facilitated. Our view is that the clarification of the existing legal text will enable the DCC and the SEC Panel, to have a clearer understanding of the obligations regarding the calculation and application of Credit Cover provisions. The draft legal text will also help to mitigate against potential misinterpretations of the SEC's Credit Cover requirements. This will allow the DCC to deliver its licence obligations in this area in a more robust manner. This will help to ensure that a transparent, and consistent approach with SEC Parties and the SEC Panel is realised.

The fourth General SEC Objective is to facilitate effective competition between persons engaged in, or in Commercial Activities connected with, the Supply of Energy under the Principal Energy Legislation.

The Proposer explains and we agree that potential misinterpretations within SEC Section J regarding the calculation of Credit Cover could affect both existing SEC Parties as well as new entrants into the market. SECMP159 will help explain these requirements resulting in a clearer understanding of a Party's obligations. These clarifications within the text will mitigate the risk to existing SEC Parties that a potential under-assessment of the cover was calculated, which in the case of a supplier failing, would leave SEC Parties exposed to a potential socialisation of the costs. The clearer language will help to explain this process, which will facilitate effective competition within the energy industry by having Credit Cover obligations applied to all Parties consistently.

The seventh General SEC Objective is to facilitate the efficient and transparent administration and implementation of the SEC.

We agree with the Proposer that SECMP159 will also better facilitate the seventh General SEC Objective. The changes outlined within the legal text will deliver efficient and transparent administration and implementation of the SEC through improved and simpler language of the Credit Cover arrangements in SEC Section J.

The solution will help to reduce misinterpretation of the Credit Cover obligations within the SEC and this will result in all SEC Parties having the same requirements applied consistently. This will help to mitigate against and reduce the risk of cost socialisation which would ultimately be borne by consumers in the event of a Party failing without having the appropriate levels of Credit Cover in place. This solution will directly result in and improve the efficient administration of the SEC with respect to Credit Cover arrangements, thereby better facilitating this Objective.

Decision Notice

In accordance with standard licence condition 23 of the Smart Meter Communication licence, the Authority hereby determines that the SEC Modification Proposal MP159 'Credit Cover Review' be made.

Michael Walls
Head of Retail Market Operations
Retail Systems and Processes

Signed on behalf of the Authority and authorised for that purpose