CUSC Workgroup Consultation Response Proforma

CMP311 Reassessment of CUSC credit requirements for Suppliers, specifically for “User Allowed Credit” as defined in Section 3, Part III section 3.27 of the CUSC

Industry parties are invited to respond to this consultation expressing their views and supplying the rationale for those views, particularly in respect of any specific questions detailed below.

Please send your responses by **29 October 2019** to cusc.team@nationalgrideso.com Please note that any responses received after the deadline or sent to a different email address may not receive due consideration by the Workgroup.

Any queries on the content of the consultation should be addressed to Chrissie Brown at christine.brown1@nationalgrideso.com

These responses will be considered by the Workgroup at their next meeting at which members will also consider any Workgroup Consultation Alternative Requests. Where appropriate, the Workgroup will record your response and its consideration of it within the final Workgroup Report which is submitted to the CUSC Modifications Panel.

Respondent:	*Sharon McCahey sharon.mccahey@sse.com 01738 456338*
Company Name:	*SSE Electricity Limited*
Please express your views regarding the Workgroup Consultation, including rationale. (Please include any issues, suggestions or queries)	**For reference, the Applicable CUSC Objectives for the Use of System** (a)The efficient discharge by the Licensee of the obligations imposed on it by the Act and the Transmission Licence; (b)Facilitating effective competition in the generation and supply of electricity, and (so far as consistent therewith) facilitating such competition in the sale, distribution and purchase of electricity; (c)Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency *; and (d) Promoting efficiency in the implementation and administration of the CUSC arrangements. **Objective (c) refers specifically to European Regulation 2009/714/EC. Reference to the Agency is to the Agency for the Cooperation of Energy Regulators (ACER).*

Standard Workgroup consultation questions

Q	Question	Response
1	**Do you believe that CMP311 Original proposal (revised since originally proposed to just remove the Payment Record Sum) better facilitates the Applicable CUSC Objectives than current arrangements?**	Please see below
2	**Do you support the proposed implementation approach, both in terms of allowing at least 12 months to make arrangements and the Workgroup suggestion to commence in April with the Financial Year?**	Please see below
3	**Do you have any other comments?**	Please see below
4	**Do you wish to raise a Workgroup Consultation Alternative Request for the Workgroup to consider?**	Please see below

Specific questions for CMP311

Q	Question	Response
5	**What impact do you think this modification would have on suppliers entering the market?**	Please see below
6	**What impact do you think this modification would have on existing suppliers and what would be the cost to your business?**	Please see below
7	**Two potential solutions other than that Proposed have been discussed by the Workgroup, what are your views on these?**	Please see below
8	**What impact do you believe this modification would have on the Consumer?**	Please see below

1. **Do you believe that CMP311 Original proposal (revised since originally proposed to just remove the Payment Record Sum) better facilitates the Applicable CUSC Objectives than current arrangements?**

(a) Efficient discharge of licence conditions

It is the Proposer's view that this change will have a positive impact on the ability of NGESO to efficiently discharge its obligations by proactively managing costs that would be borne by consumers in the event of a future default. However, shifting costs from NGESO to suppliers is not the same thing as managing costs for the consumer. There are costs associated with both current and proposed arrangements. Both approaches are ultimately paid for by the consumer and it is essential to understand and compare the costs involved in order to identify the best outcome for the consumer.

NGESO have identified their current potential losses – if not met by administrators nor Ofgem's debt recovery mechanism - as £1.5m. If losses are recovered by the latter the cost of debt will also be included. The total cost will then be £1.5m plus the cost of internal credit (for example at 0.5% per annum – a total of £1.5075m).

The alternative proposed is that security in cash or Letters of Credit should be provided by suppliers to cover the potential risk of their failure. These will be required from those with low or no credit rating such that the recognised industry standard share of their risk is reflected within an effective risk management framework. Although Ofgem's most recent publication suggests a figure of 0.5%, these credit costs will likely be above 2% and it's been suggested could be as high as 8% per annum for some. NGESO has not yet identified the number of suppliers or Credit VAR that would need to provide this cover. Therefore, the comparative to the current costs suggested above is not available. If 20% of the £220m current unsecured payment record aggregate had to be covered at 6% that would be an upfront annual cost of £2.64m. Without a proper cost assessment, this proposal cannot be shown to decrease costs to consumers. NGESO would benefit by no longer temporally carrying the costs as suppliers would do that instead. Rather than consumers potentially funding £1.5075m annually through Ofgem's guaranteed recovery mechanism, they would be presented with an as yet uncalculated amount. It is important to note that for those unable to secure credit this proposal is an exit mechanism, with all of the subsequent mutualised costs.

(b) Facilitate effective competition in supply

In the Proposer's view this modification positively facilitates effective competition by removing a real financial risk to NGESO which is later said to threaten its credit rating. However, Ofgem say 100% debt recovery is permitted and Moody's say NGESO's rating is based on the reliability of Ofgem and this mechanism.

We believe that increasing the barriers to entry does not, as suggested, support new suppliers into the industry. Further, Ofgem are addressing new suppliers and existing suppliers in their New Entrants Review – it is not for NGESO or CUSC to supersede Ofgem's quality threshold to new entrants or for existing ones. We disagree that this Proposal will make it more likely that suppliers will endure in the market place and highlight Ofgem's new proposals relating to milestone assessments which will allow them to impose appropriate measures on suppliers causing concern.

Competition should not be curtailed nor distorted in order for NGESO to avoid a risk neither Ofgem nor Moody's identify as substantial. By shifting all exposure risk from NGESO to suppliers the proposal asserts that entrants will understand their responsibility to manage their own risks. However, NGESO has separately published its RIIO 2 response wherein it says it is not a business that simply passes through costs but rather seeks to manage risk and costs on behalf of industry and consumers. It proposes it should be funded to continue this.
We ask that Ofgem, in considering credit changes within their SLR and ongoing impact assessment, take a coordinated cross-code perspective and also consider the impact of potential changes in transmission and distribution.

d) promote efficiency in the implementation and administration of CUSC arrangements

It is suggested the Proposal will promote efficiency as monitoring will be reduced - reducing the burden on NGESO. However if there is a shift to security such as Letters of Credit more frequent monitoring will be required and a greater amount of administration will be unavoidable given the increased number of security instruments which will require review and amendment potentially every quarter. Further, the NGESO will require increased resources to handle the greater amount of supplier interaction that will be necessary.

2. Do you support the proposed implementation approach, both in terms of allowing at least 12 months to make arrangements and the Workgroup suggestion to commence in April with the Financial Year?

We believe any change to credit cover requirements should commence with the Financial Year occurring at least 12 months after a decision from Ofgem. This would allow for a planned and budgeted change from those who have credit lines available; would allow others to develop relationships with potential banking partners and would allow Ofgem to assess the number of suppliers forced out of the market in time to put a strategic and appropriate plan in place. We would ask Ofgem to be mindful of possible changes occurring in other codes - which may implement at the same time - and could overburden suppliers without careful planning.

4. Do you wish to raise a workgroup consultation alternative request for the workgroup to consider?

No

5. What impact do you think this modification would have on suppliers entering the market?

New suppliers should follow Ofgem's new market entry requirements and as such are likely to have had a business plan approved and to have evidenced their ability to meet their requirements and cashflow needs. As such in the first year they will already be sufficiently prepared. This modification should not interfere with Ofgem's intentions. Creating barriers to entry is not an acceptable credit arrangement change permitted within the policy guidelines published by Ofgem and by definition will prevent new suppliers entering the market.
If NGESO are serious about helping new suppliers "understand their responsibilities" then rewarding good payment behaviour and immediately addressing and disincentivising late payment issues would seem particularly appropriate. Ofgem's guidelines seem especially well thought out in this regard and remain apt. However, during discussions of recent failures NGESO highlighted that

- Late or non-payment does not immediately result in the removal of unsecured credit
- An issue of particular concern to NGESO in relation to new suppliers was rapid, unforecast growth potentially above and beyond forecasts, lodged credit or ability to pay.

It could therefore be concluded that the proposal's impact on new suppliers, when it matters most, would be ineffectual but that Ofgem's latest monitoring and intervention proposals will target these issues quire specifically.

6. What impact do you think this modification would have on existing suppliers and what would be the cost to your business?

Ofgem's Best Practice Guidelines say it is a requirement of any modification to bring about a more stable market and not exacerbate failures. If there are a number of suppliers in difficulty this modification will cause some of them to fail. Credit lines with Banks cannot be obtained off-the-shelf. The cost of credit for some suppliers will be so expensive as to be unobtainable. As these suppliers fail, and mutualised costs mount, further suppliers could be pushed into difficulty and a cascade triggered. If consolidation is occurring this could be hindered by the addition of new collateral requirements and a developing market solution may be prevented.

We are concerned that the debt burden already allocated to the remaining suppliers could be increased by the networks' attempts to de-risk their involvement in the sector.
The costs of this modification need to be understood and at this time only NGESO has a sufficient overview of

- the full list of actively participating licence holders,
- the individual credit VaRs involved,
- the identity of those suppliers who by this modification will have zero credit allowances from Experian, Dun and Bradstreet and Graydon's.

The comparative costs depend upon whether the suppliers can move to an Independent Assessment Allowance or will have zero unsecured credit. If all are sufficiently rated or scored there is no cost and no reduction in unsecured credit to NGESO. Each individual supplier may have an assumption of the cost of credit that they can access, however without the above data the cost as a whole cannot be calculated. Only NGESO can currently make this assessment.

For SSE Electricity Limited, in its second year of operation, the payment record sum that would be removed through this modification would be smaller than the five year maximum - although it will have increased by implementation date. The cost to the business will be determined by the outcome of the proposed business sale and the financial arrangements that the buyer may have in place. It is possible the business may avail of an Independent Assessment such that sufficient unsecured credit will be available.

7. Two potential solutions other than that Proposed have been discussed by the workgroup, what are your views on these?

We do not believe a defect exists. If a change to Payment Record Sum was made we believe it should tie in with Ofgem's New Supplier Review. If permitting a Payment Record Sum aligns with this then we would support its maintenance for the newest suppliers via Alternative B.

8. What impact do you believe this modification would have on the consumer?

As discussed, the costs of this modification need to be better understood. NGESO, a private company, have throughout Workgroup discussions identified their costs as being ultimately the consumers' costs. They have not acknowledged that, especially since the introduction of the Price Cap, the same applies to industry costs. Without an assessment of the credit VaRs that may need collateralised and the associated costs it is impossible to calculate if there are additional costs arising from this proposal that will be imposed upon consumers.

3. Do you have any other comments?

NGESO asserts there is a defect in code credit arrangements**:** *suppliers can earn an unsecured credit allowance with NGESO up to a maximum of 2% of NGET revenue by good payment record. At NGET's current RAV this increases each month by c£100k up to a maximum of £6m after 5 years. It is proposed that the increase in unsecured credit arising from the larger number of suppliers now participating increases the risk to NGESO and, if suppliers fail, potentially the costs to future consumers.*
We consider there be three possible options, either

- NGESO has separated from NGET and has a separate applicable RAV (c£198m), in which case what are identified as large unsecured risks no longer exist
- NGESO is still sufficiently tied to NGET for the larger RAV (c£14,696m) to be appropriate, in which case NGESO is not materially impacted

- or there is a hybrid situation where, in reality, the close interdependent relationship between the two National Grid Group companies means a strict separation is not something that can be applied here without impacting NGESO or National Grid Group in other regulatory or financial endeavours.

The Workgroup has said if the NG companies are separate then the lower NGESO RAV should apply, in which case what NGESO describe as large amounts of unsecured credit should have been reduced to 1.3% of former values from April 2019. But NGESO have said that the NGET RAV still applies for the calculation of unsecured credit allowances. At the same time, however, the Proposer says they can no longer carry these risks as they now have no assets. The Proposer has said the code should be revised because NGESO now operates as a separate business. It seems more apt for NGESO to clarify their business model.

It is debatable whether NGESO's risk has grown and it is in in doubt if NGESO has a decreased ability to handle risk. What is clear is that Ofgem have reaffirmed to the Workgroup that their Best Practice Guidelines (BPG) still stand. These say in a competitive market some failure is inevitable and they provide a mechanism for NGESO to recover up to 100% of its costs. Thus, we conclude no defect exists.

We believe there are ways that NGESO could address their potential cashflow volatility which would better serve their concerns.
Under forecasting has repeatedly been highlighted as a risk driver but is not an issue remedied by removing Payment Record Sums. Supplier under forecasting is currently permitted up to a 20% tolerance threshold before a reforecast is required. The Proposal says there is a £102m under forecast. It has been suggested that a tolerance threshold of 10% or even 5% could be implemented and that this would have a more direct effect on under recoveries. Also, in relation to under forecasting it was suggested in the Workgroup that the credit penalty which applies the year after an under forecast could be brought forward to apply immediately from the point that the tolerance is breached. These two measures would reduce NGESO's cashflow concerns and increase the operational credit VaR more rapidly for an under forecasting supplier.

NGESO presented data to the Workgroup showing the challenges faced when a supplier has a period of rapid growth. It would seem that whilst this is the greatest risk scenario to NGESO there are no proposals being offered to address this situation. Without immediate action, NGESO is exposed to significant jumps in customers. This is identified as a cause for concern but is not addressed by this proposal. Even if a supplier has collateral in place NGESO will always be playing "catch-up" – they never get ahead of the increasing VaR by this methodology. NGESO should focus on companies presenting these risks and coordinate their approach with Ofgem's new proposals to mitigate these risks through early intervention.