Supplier of Last Resort (SLCs 29, 29A, 29B, 33 and Gas SLC 22B) –Report to Steering Group.

The purpose of this document is to provide a summary of the views discussed in the Part B workgroup on supplier of last resort (SoLR). Please note that this paper is for discussion purposes only and does not seek to represent the view of the Authority. The specific SLCs being considered are:

SLC 29 - Supplier of Last Resort
SLC 29A – Supplier of Last Resort Supply Payments
SLC 29B – Provision for Termination Upon a Direction
SLC 33 – Last Resort Supply: Security for Payments
SLC 22B – (Gas only) Undertaking to be given by Licensee to a Relevant Transporter in Respect of Shipping Charges etc.

Note: Where the phrase **'The group agreed to retain this provision'** is used this does not imply that the drafting can not be improved.

Note: There are definitional references in SLC48 of the electricity distribution licence to SLC29 and SLC29A.

SLC 29 - Supplier of Last Resort

1. SLC 29(1) and (2) permits the Authority to direct the licensee (a "last resort supply direction") to act as a SoLR unless, in the view of the Authority, the supplier would be unable to supply its own customers if required to be a SoLR. **The group agreed to retain this provision**

2. SLC 29(3) states that the appointment shall take effect from the date of the revocation of the old supplier's licence and will continue for no longer than 6 months. **The group agreed to retain this provision, revising the wording so that appointment takes place from the "time of revocation of the others supplier's licence"**

3. SLC 29(4) requires the SoLR to supply those customers specified in the direction. Typically this is 'the supply points registered to the failed supplier'. **The group agreed to retain this provision.** The group noted that where a direction was made retrospectively, the period should be kept as short as possible. Ofgem agreed, and stated that it was unlikely in practice that a retrospective period would be longer than 24 hours and suppliers bidding to be a SoLR would be informed. The SoLR guidance notes would be updated to reflect this position in due course.

4. Under SLC 29(5) the SoLR will not be obligated to supply sites where ordinarily it would not be required to. However, SLC 32 is itself under review, so the approach here may need to be revisited to achieve the same outcome.

5. SLC 29(6) and (7) require a letter approved by the Authority to be sent to customers explaining:

    a. what has happened,

b. the terms of supply, and

c. when the licensee was appointed as the SoLR.

6. The Authority would also expect (as per the guidance notes) this letter to confirm that under a deemed contract, the customer is free to terminate their deemed contract with the SoLR should they wish to switch to a supplier of their choice. Ofgem suggested that this requirement be included in the licence condition. The group had different views on this issue:

   a. The view of ERA suppliers is that this obligation should not be introduced into the supply licence. They argue that it is unnecessary, that a supplier should not be required to encourage its customers to leave it, and "*that it must be assumed that Ofgem in its statutory consumer protection role will, through the SoLR appointment procedure, have selected the optimum rescue deal available from the market at that time and in all the particular circumstances of the supplier insolvency in question*." (a view not shared by Ofgem). A paper from the ERA paper is attached below (Appendix 1).

   b. Energywatch agreed with the Ofgem proposal, and argued that the circumstances of the appointment of a SoLR were unusual and a major disruption of the normal commercial contracting arrangements between customer and supplier. Every opportunity should be taken to make the position clear to customers, in particular on the circumstances under which the customer could move to their preferred contract terms, whether that be with the SoLR or not (See Appendix 2).

   c. A number of non-ERA suppliers advised Ofgem that they supported the Ofgem proposal noting the confusion that some customers had expressed about their new contract terms.

   d. The Steering group agreed that were the obligation to be added to the licence then the requirement in SLC 29 (6) for the letter to be approved by the Authority should be removed.

7. SLC 29(9) and (10) require the appointed SoLR to secure a meter reading within 14 days of the last resort supply direction unless it is not economic or feasible to do so or it would require entering the premises without the consent of the occupier of seeking entry on more than one occasion. The group considers that this obligation to be potentially excessive. The 2003 guidance notes refer to the provision of advice to customers to take their own meter reads and recognises that the size of the portfolio will dictate the practicalities of meeting this requirement. Ofgem proposed a change in emphasis to that of the current drafting along the lines of "the licensee should take reasonable steps to ensure that actual or estimated meter readings are secured to enable acceptable and timely billing of consumers" **The Group endorsed this approach.**

8. SLC 29(11) describes constraints on the deemed contract charges that can be made. SLC 29(12) states that if the original charges declared by the SoLR at the

time of their appointment are increased following SLC 29(8)[1], and that there is a risk of hardship for domestic customers, the charges could be capped to a level set by Ofgem, but not (SLC 29(13)) less than those for that supplier's other deemed contract customers. The proposed charges would have to be very high to risk customer hardship, given that customers are free to switch to an alternative supplier and therefore customers need only be exposed to them for a short period. **The Group agreed to remove SLC 29 (8), (12) & (13), but retain SLC 11.**

9. SLC 29(14) introduces a non-discrimination requirement. Ofgem consider that this may not be needed, given that the Direction to a SoLR requires them to take responsibility for supply from a specified date. However, clarification that the SoLR is expected to register sites in a timely manner may be required. This could be linked to paragraph 6 above. **The group agreed to remove SLC 29 (14).**

10. SLC 29(15) has something of the 'for avoidance of doubt' about it given that it reminds us of the arrangements in SLC 28(9) on the deemed contract termination arrangements. There may be a case for combining these requirements given the references in SLC 28 to SLC 29. **The Group agreed that this should be considered at drafting stage with SLC 28.**

11. SLC 29(16) requires the SoLR to purchase energy economically. SLC 29(16) has to be read in conjunction with SLC 29(11) and SLC 29A.There is a risk that a supplier could act in such a way in its energy purchasing arrangements as to undermine the obligation to have 'reasonable costs of supply'. Arguably, this may only have a direct effect in calculating the unrecovered losses for a claim under SLC 29A, but there is merit in retaining it to support SLC 29(11). **The group agreed to retain this provision.**

SLC 29A - Supplier of Last Resort Supply Payments

12. SLC 29A sets out the process by which a claim would be made and how the Authority would approve a claim for payment. **The Group agreed to retain the provisions of SLC 29A, acknowledging that it would need extensive redrafting.**

SLC 29B – Provision for Termination Upon a Direction

13. This condition requires the licensee to ensure that its supply contracts will terminate following a last resort supply direction. It could be argued that this is unnecessary, given that to continue to supply without a licence would be an offence under the respective Act. However, it reduces the potential for risk of disputes with an administrator and a SoLR and makes the situation unambiguous for the customer. **The group agreed to retain this provision and advised that it should be combined with other termination arrangements in the final drafting.**

[1] Well, it does in the electricity licence. The gas licence incorrectly refers to (9), There are a number of such errors in cross referencing which will need to be resolved.

SLC 33 – Last Resort Supply: Security for Payments

14. **The group agreed to remove this licence condition**. Ofgem consulted in June 2001[2] on the level of the security cover that domestic suppliers should have in place to pay for the unrecovered costs of a SoLR. As a result of that consultation, security cover was set at £0.00. Ofgem has seen no reason to revise that view since.

SLC 22B – (Gas only) Undertaking to be given by Licensee to a Relevant Transporter in Respect of Shipping Charges etc.

15. This condition contemplates the situation which can occur in gas where a shipper and a supplier are separate companies and requires the supplier to have in place arrangements with the relevant transporter. Were the shipper to fail, the customers continue to take power, disconnection is not a practical or desirable option and the smearing of charges across the wider community is unsustainable. However, there is still a supplier in place who is able to bill customers and they should be obliged to put in place new shipper arrangements. **The group agreed to retain this provision, subject to far simpler drafting.**

[2] http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/288_14june01.pdf?wtfrom=/ofgem/whats-new/archive.jsp

Appendix 1

Supply Licence Review: Section B Issues Workgroup

SoLR COMMUNICATIONS WITH CUSTOMERS

Paper for the Steering Group from: EDF Energy, Centrica, Npower, Powergen, Scottish Power, and SSE

1. Section B of the supply licence deals with, inter alia, procedures for the appointment of a supplier of last resort (SoLR) to take over responsibility for continuing the supply of energy to the customers of another gas or electricity supplier who has become insolvent and whose supply licence has been revoked by Ofgem.

2. The workgroup responsible for Section B issues has been able to reach a broad consensus on most of the recommendations set out in its report to the Steering Group. However, a sharp difference of opinion has arisen between suppliers on the one hand, and Ofgem/energywatch on the other, in relation to the contents of the letter which the supplier is required by licence obligation to send to its newly acquired customers following its appointment as a SoLR.

3. The matter in question is governed by the provisions of SLC 29 (6) and (7). In detail, SLC 29 (6) requires the SoLR within two working days of its appointment to send Ofgem a draft of the information letter that it proposes to send to its new customers, while SLC 29 (7) requires that any such letter must tell those customers three things**:**

(a) that the failed supplier is no longer supplying them;

(b) that the SoLR is now their supplier and has been so since the date of its appointment; and

(c) the charges payable (or how they are determined).

4. Ofgem must approve the form and the content of this information letter, except for the charging details. And the SoLR must send the letter to all of the customers for which it has become the new supplier as soon as reasonably practicable after Ofgem has approved it.

5. The terms of SLC 29 (7) do not require that the information letter shall "include" the three items listed above**:** on the contrary, the terms are exhaustive of the matter, in that they entitle the SoLR to expect that its letter must be approved by Ofgem provided that it comprises those three things. There is no requirement for the SoLR to have regard to any guidance issued by Ofgem in connection with the condition.

6. All the newly acquired customers of a SoLR are supplied pursuant to the terms and conditions of a deemed contract. A deemed contract is a supply contract, permitted by statute and regulated by Ofgem, into which the customer has not been able to enter freely.

7. During the workgroup's discussion of SoLR issues, Ofgem has made clear that it believes that a fourth prescribed element should be added to the three existing elements of the SoLR's information letter. The new element would be a statement to the customer that he/she is free to switch from the SoLR to a new supplier. The rationale for this is that customers may need to be reminded that they are free to shop around for the best terms the market is able to offer, and that the person who should be obliged to remind them of this right is the SoLR.

8. Ofgem believes that its published guidance about the operation of SoLR procedures already effectively requires the SoLR to incorporate this further requirement into its information letters. However, the guidance is not legally binding and it is not clear that a blanket policy of refusing to approve a SoLR's letter unless it expressly states that the customer is free to leave the SoLR for another supplier would be lawful, having regard to the precise terms of SLC 29 (7).

9. The suppliers strongly oppose Ofgem's proposal to make the new fourth element a requirement of the licence. They point out that customers are both well aware of the competitive supply market and constantly reminded of it by Ofgem, energywatch, and the mass media. They also say that it must be assumed that Ofgem in its statutory consumer protection role will, through the SoLR appointment procedure, have selected the optimum rescue deal available from the market at that time and in all the particular circumstances of the supplier insolvency in question.

10. It is of course accepted that the SoLR's deemed contracts will not have been entered into freely by the rescued customers. However, the legal framework in which Ofgem currently operates requires that the promotion of competition is not to be treated as a regulatory objective in itself, but only as a preferred means, where it is appropriate, to the achievement of the over-arching objective of consumer protection.

11. By virtue of SLC 29 (15), the SoLR's deemed contracts are required to allow for termination from the moment that a customer takes supply from another supplier. In order not to prejudice the key competitive principle while nevertheless securing the wider regulatory objective, it should be sufficient for Ofgem to satisfy itself that the SoLR's deemed contracts comply with that requirement.

12. The Steering Group is invited to endorse the suppliers' case above and to recommend Ofgem to abandon its proposal. So far, failing supply companies have been quite small. If a larger company should fail, the prospect of customers leaving in droves will adversely affect SoLR bid prices and, therefore, the consumer protection objective. No company, in any industry, should be required by law to have to encourage its customers to leave it – which is what the proposal really means.

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Appendix 2

Comments from energywatch

"energywatch believes that the current information required by SLC 29(6) & (7) (the requirement on the SoLR to send a letter to customers informing them that a SoLR had been appointed) should be retained in any future SLC. In addition, energywatch has been asked for its view on Ofgem's intention to include, as part of SLC29 (7), a new obligation that requires the SoLR to indicate in the letter that the customer has the right to switch to another supplier. energywatch supports Ofgem's intention on the following grounds:

- the SoLR experience is an extraordinary phenomenon, one in which existing contractual relations entered into willingly by the consumer by choice, are overridden by events outside the consumer's control. Regardless of how informed the consumer may be about the normal switching process, the SoLR experience imposes a whole new layer of relations, and it is only equitable that these are spelt out clearly in detail, including the consumer's right to switch.

- however affected all consumers are by such an event, the financially more vulnerable consumer can potentially be even further disadvantaged by a transfer to another supplier on SoLR rates. It is therefore doubly imperative that such consumers know exactly where they stand and what their rights are to remain or to switch away from the SoLR. In practice it may be difficult, or even impossible, to identify such a group of consumers and therefore, by providing this information to all affected consumers, there can be no doubt that suppliers have done all that can reasonably be asked of them under the circumstances.

- suppliers may well be concerned about losing customers acquired under the SoLR arrangements. However, it is energywatch's belief, which suppliers have confirmed at the SLR work group, that any supplier would have factored into its original bid to become a SoLR that a proportion of customers may be lost shortly after the appointment, and so the risk of losing customers would be reflected in its 'bid' price.

- even if the supplier has not made such a calculation, or over- or under-estimated the possible loss of a proportion of customers after its appointment as SoLR, the supplier is still in a much better position to manage any risks involved in purchase or sale of energy associated with becoming a SoLR. After all, this is what suppliers do on a daily basis in terms of energy management, trading and balancing of positions in relation to wholesale energy markets, since, in a competitive market, they gain or lose customers with regularity. Suppliers cannot argue that they operate in a mature competitive market and then assume that customers owe some higher loyalty to a SoLR for rescuing them in the unique circumstances pertaining to a SoLR appointment which arise through no fault of the customer.

- currently, the provision to require suppliers to include notification in the SoLR letter to customers that they can switch is contained in guidance provided by Ofgem. Ofgem have stated that it would not countenance approving a SoLR letter that did not contain notice of this consumer right. energywatch would rather see the situation regularised by inclusion of this obligation in the SLC along with the other

requirements on suppliers in relation to the SoLR letter, rather than being part in an SLC and part in guidance. It is inconsistent to do otherwise."