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Making a positive difference for energy consumers

Gas and Electricity Suppliers,

Electricity Distribution Network Operators,

Gas Transporters

and all other interested parties

Email: supplier@ofgem.gov.uk

Date: 19 November 2021

Dear colleague,

Last Resort Supplier Payment Claim from ScottishPower Energy Retail Limited

On 29 October 2021, ScottishPower Energy Retail Limited ("ScottishPower") gave notice to Ofgem of its intention to submit a claim for a Last Resort Supply Payment ("LRSP"). ScottishPower is seeking to claim additional costs incurred in acting as Supplier of Last Resort (SoLR) to customers of the former Daisy Energy Supply Limited (which traded under the name of "Yorkshire Energy").

As per Supply Licence Condition 9, a SoLR may make a claim for a LRSP from relevant distribution networks where we have given our consent to the amount claimed. The claim from ScottishPower included its calculation of the claim amount and information to support the calculation (outlined in Table 1).

This letter sets out the reasons why we are minded to consent to ScottishPower claiming a Last Resort Supply Payment of up to £2.4m.[1] We are minded to allow ScottishPower to claim for the costs of protecting the credit balances owed by Yorkshire Energy to the customers ScottishPower acquired, in line with commitments given at the time of the SoLR appointment, and certain other costs incurred as part of undertaking the role of a SoLR.

The purpose of this consultation letter is to provide interested parties with an opportunity to make any representations to us, ahead of us making our final decision. We currently expect to make our final decision in December 2021, to enable the agreed amount to be recovered from relevant gas and electricity distribution companies in 2022/23.

We recently published an open letter on our proposals for temporarily accelerating the LRSP claim process. The proposals set out a multiple claim approach to allow SoLRs to recover initial costs associated with acting as a SoLR more quickly than normal. We have proposed these temporary changes in recognition of the extremely challenging conditions the market is currently facing.[2]

However, for clarity, since Scottish Power was appointed as SoLR for the customers in Yorkshire Energy in December 2020, this claim is being processed under our standard

[1] Total minded-to claim amount of £2,407,071.98.

[2] https://www.ofgem.gov.uk/publications/letter-suppliers-supplier-last-resort-levy-claims

procedure and timelines. It therefore reflects the full amount to be claimed in respect of this appointment.

Background

The SoLR process

Electricity and gas supply is a competitive activity in Great Britain. As in any competitive market, companies that are not operating efficiently may exit the market. This applies as much in relation to the gas and electricity supply markets as it does to other markets.

When a supplier ceases to trade, our focus is to ensure continuity of supply for its customers and to minimise wider negative impacts on the market. These wider effects stem from the fact that if an energy supplier ceases trading, its customers will continue to be physically supplied with gas and / or electricity, but the supplier will not be able to meet the costs of providing this energy. In these circumstances, the costs of procuring the necessary electricity will be smeared across all suppliers and the costs of procuring gas will fall to the relevant shipper. There is also the real risk that if a supplier ceases to trade without urgent intervention, consumer trust and confidence in the energy market would be materially damaged.

Ofgem can ensure continuity of supply to the supplier's customers and minimise these wider negative effects by appointing a SoLR to supply the supplier's customers at very short notice.[3]

Yorkshire Energy SoLR event

On 05 December 2020, we appointed ScottishPower as the SoLR[4] for Yorkshire Energy's gas[5] and electricity[6] customers following its announcement that it was ceasing to trade. This followed a competitive process aimed at getting the best deal for consumers, in line with our principal objective to protect the interests of existing and future consumers and our published guidance.[7]

At the time of Yorkshire Energy's exit, we received a number of submissions from suppliers, setting out the terms they would offer to customers if they were to be appointed as the SoLR. We outlined the material factors behind our decision to appoint ScottishPower as the SoLR in our decision letter published on 17 December 2020.[8]

Claim for Last Resort Supply Payment

As set out in the gas and electricity supply standard licence conditions, a supplier may make a claim for any additional costs they incur in complying with a Last Resort Supply Direction (LRSD).

As part of their competitive bid to become a SoLR, a supplier will include whether they expect to make a claim for a Last Resort Supplier Payment, or whether they wish to waive this right. As stated in our revised guidance, our preference is for the SoLR not to make any claim, and we expect efficient SoLRs to be able to minimise their exposure to

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[3] The obligation for a supplier (such as ScottishPower) to comply with a LRSD derives from standard licence condition 8 of each supplier's gas and electricity supply licences. The duties of a SoLR are further described in our Guidance and the LRSD contains specific details of ScottishPower's obligations to supply Yorkshire Energy's former customers.
[4] https://www.ofgem.gov.uk/publications/ofgem-appoints-scottish-power-take-customers-yorkshire-energy
[5] https://www.ofgem.gov.uk/publications/daisy-energy-supply-limited-notice-revocation-gas-supply-licence
[6] https://www.ofgem.gov.uk/publications/daisy-energy-supply-limited-notice-revocation-electricity-supply-licence
[7] Ofgem, Supplier of Last Resort: Revised Guidance 2016, October 2016
[8] https://www.ofgem.gov.uk/sites/default/files/docs/2020/12/decision_letter_yorkshire_0.pdf

otherwise unrecoverable costs to reduce the costs smeared across the rest of the market.

In our guidance, we explain that we will decide on a case-by-case basis whether it might be appropriate for a SoLR to make a claim under these arrangements. We also explain that we would consider whether the amount of any claim or the reasons for any claim were reasonable. In that guidance, we note that, in certain circumstances, we may consider it appropriate to approve a claim where it relates to costs associated with the protection of customers who held a credit balance with the failed supplier.

ScottishPower indicated at the time of our SoLR appointment process that it would not waive its right to make a claim, but that it would claim only for the cost of credit balances greater than £5.8m and any associated costs including working capital.

Table 1: ScottishPower SoLR Levy Claim

Item	Cost Category associated with SoLR	Cost item to be claimed by ScottishPower (£)
1	Domestic customer credit (active and closed) balances above £5.8m	£2,174,080.01
2	Working capital	£232,991.97

Our decision process and methodology

Our process to reach our minded-to position consisted of:

- A quantitative check of ScottishPower's methodology for each cost item claimed. This included determining how each total cost item was calculated based on data sent to us by ScottishPower and ensuring these costs were in line with commitments ScottishPower made at the time of its SoLR appointment.

- Undertaking validation of some assumptions with other data sources, where appropriate.

- A qualitative assessment of the claim for credit balances against our methodology criteria.

Our methodology criteria for SoLR levy claims are as follows:

- **Additional**: whether the costs claimed are additional to the costs to the SoLR of serving existing customers. In addition, we consider whether these costs would have been expected at the time of the SoLR's bid and whether any commitments were given in relation to these costs in their competitive SoLR bid. Although the SoLR is generally expected to know or predict to some extent the costs they will incur in serving a new customer base and take these into account in their competitive bid, there may be cases where this is not possible.

- **Directly incurred as part of the SoLR role**: whether the costs were incurred as a result of taking on customers in an emergency situation as opposed to normal customer acquisition routes. It would not be appropriate for us to allow the SoLR to claim for costs they would have incurred through a normal acquisition route.

- **Otherwise unrecoverable**: whether the SoLR could have recovered the costs through other means. It would not be appropriate for us to allow the SoLR to claim for costs it could have recovered through the administration process or customer charges, for example.

- **Unavoidable**: whether the SoLR had made all reasonable efforts to avoid the cost in the first instance, or absorb the cost.

- **Efficient**: whether the SoLR has taken all reasonable steps to reduce the magnitude of any unavoidable and unrecoverable costs incurred, and therefore the total amount claimed.

Our minded-to decision

On balance, given all specific circumstances of this levy claim case and taking into consideration all information available to us, we are minded to consent to ScottishPower claiming a Last Resort Supply Payment of up to £2.4m.[9]

Our position would enable ScottishPower to recover up to this amount through relevant network charges in the period 2022/2023. This is subject to any costs recovered from the liquidation process.

For the avoidance of any doubt, we consider on a case-by-case basis whether it may be appropriate for any SoLR to make a claim on the levy. We have set out below our reasons for our minded-to position for this case. This should not be taken as setting a precedent for any future claims, which would also be considered on their merits and on a case-by-case basis, taking into account all relevant circumstances of the particular case.

Reasons for our minded-to decision

Cost item: Credit balances

Our published guidance sets out that we may in certain circumstances consider it appropriate to approve a claim associated with costs incurred in repaying credit balances to customers who had a positive credit balance with a failed supplier. We are satisfied in this case that (subject to the points discussed below) the claimed amount is consistent with the relevant criteria and in particular, is consistent with ScottishPower's commitment in its SoLR bid.

The Gas and Electricity supply licence does not provide for credit balances which have come about as a result of supplier reward schemes to be claimed via the LRSP.[10] Yorkshire operated a loyalty scheme. Yorkshire Energy's administrators, in partnership with ScottishPower identified £95,310 of credit balances associated with this scheme. While these credit balances have been returned to the former customers of Yorkshire Energy by ScottishPower, we are minded to reject ScottishPower's claim for these credit balances on the basis that they cannot be claimed via the LRSP.

We have considered whether the costs ScottishPower is seeking to claim for credit balances are otherwise unrecoverable; it may still be the case that ScottishPower is able to recover some of this claimed amount through the ongoing administration process for

[9] Total minded-to claim amount of £2,407,071.98.
[10] See SLC 9.10, definition of "credit".

Yorkshire Energy, where it has submitted a claim in respect of credit balance. We propose to make our final decision on ScottishPower's claim ahead of the conclusion of the liquidation process – the timescale of which is uncertain. Given this, we are minded to approve this element of the claim, subject to the outcome of the Yorkshire Energy liquidation process. At this point, the final amount ScottishPower can claim would be adjusted to include any additional costs recovered through the liquidation process not recovered at the time the claim was made to Ofgem.

Cost item: Working Capital

In the period between its appointment as SoLR and recovering funds through the industry levy, ScottishPower will have incurred costs in making capital available to fund costs associated with the SoLR process – specifically the costs involved with returning customer credit balances above the £5.8m committed to in ScottishPower's original SoLR bid. ScottishPower's LRSP claim includes £232,991.97 for the cost of working capital. We are minded to agree that the methodology used to calculate this element of ScottishPower's claim is appropriate subject to minor changes in its assumptions regarding the LRSP recovery period as suggested by Ofgem, and adjustments to remove costs associated with the £95,310 of credit balances associated with Yorkshire Energy's reward scheme.

The calculation includes costs incurred over the course of a number of months to reflect actual costs incurred and the timescale for the recovery of those costs. ScottishPower was appointed on the basis that a claim could be made for the cost of interest on working capital. We are therefore minded to approve this element of the claim. Our decision on the final amount we consent to for the cost of working capital will reflect the most up to information at that time.

Recovery of LRSP claim

ScottishPower will begin to receive repayment of the sum we consent to be recovered from electricity 3 months after presenting a valid LRSP claim to relevant electricity distributors, and for the payment of the relevant amount to be completed within a further 12 months. The amount we consent to be recovered from gas will be recovered by relevant gas network charges in 2022/23.

Summary

On balance, we are minded-to consent to ScottishPower claiming a Last Resort Supply Payment of up to £2.4m.[11]

Next steps

The purpose of this letter is to provide interested parties with an opportunity to make any representations to us, ahead of us making our final decision. We invite any representations by **03 December 2021**. Responses should be emailed to supplier@ofgem.gov.uk.

We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so that they can be placed easily on our website.

We will take into account all relevant information, including any representations we receive, in reaching our final decision on ScottishPower's claim. We currently expect to confirm our final decision by the end of **December 2021**, to enable the portion of the

[11] Total minded-to claim amount of £2,407,071.98.

approved claim attributable to electricity to be recovered from distribution network operators in 2022/2023[12] and from relevant gas network charges in 2022/23.

Yours faithfully,

Barry Coughlan

Head of Licensing Frameworks

[12] With payment by the DNOs commencing no later than 3 months after the DNOs are in receipt of a valid claim and payment being completed no later than 15 months after a valid claim is presented.