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Open letter about recovery of Last Resort Supply Payment claims from customers connected to GDN and IGT networks

This open letter relates to recovery of Last Resort Supply Payment (LRSP) claims arising from failed energy suppliers going through the Supplier of Last Resort (SoLR) process.

We are consulting on options for the recovery of an LRSP claim from domestic customers connected directly to Gas Distribution Networks (GDNs) and those connected via Independent Gas Transporters (IGTs)¹ who are licensed by the Gas and Electricity Markets Authority (GEMA)².

We are consulting on three options for an interim solution relating to 2022/23 charges and an enduring solution applicable to charges from April 2023.

Background

When a supplier fails, the only routes by which Ofgem can protect customers from significant harm is through the Supplier of Last Resort (SoLR) process, or, where that is not possible, through the Special Administration Regime (SAR). The SoLR process allows the SoLR taking on customers to claim its net costs of doing so via the LRSP. The network licences require that GDNs and electricity distribution networks pay a valid LRSP claim presented by a SoLR.

The way in which SoLR levies are socialised across energy consumers and paid to the SoLR means that those significant costs have been included in electricity and gas distribution charges for 2022/23. The existing charging arrangements raise the issues of whether or not gas customers connected via an IGT network are charged the same costs as those connected directly to a GDN network and whether or not shippers to IGT customers would receive a windfall gain. Ofgem recently issued a consent intended to facilitate recovery evenly between gas customers connected directly to a GDN network and those connected via an IGT network³.

This consent will result in a fair proportion of LRSP costs being allocated to customers connected via an IGT, and as discussed in the consent letter, Ofgem's current thinking is that the IGTs will transfer the revenue received through SoLR charges to GDNs.

¹ Independent Distribution Networks are those distribution networks who have Section B of the electricity licence switched off.

² References to 'the Authority', 'Ofgem', 'we', 'us', 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.

³ [Recovery of Last Resort Supply Payment \(LRSP\) claims arising from failed suppliers through customers connected to IGT networks \(ofgem.gov.uk\)](#)

When the GDNs set transportation charges for 2022/23 they did not foresee the receipt of this money from the IGTs, and hence there is a range of options regarding how this unforeseen money received from IGTs is returned to consumers via lower GDN transportation charges.

Options for an interim solution

Interim option 1 is currently our preferred interim option, subject to further thinking and consultation responses, and would involve an intra-year revision to tariffs by GDNs. The SoLR continues to be paid directly by GDNs. Other options include both GDNs and IGTs paying the LRSP claims, and a revision to 2023/24 charges.

Interim option 1 – intra-year revision to network charges

Our currently preferred interim option, subject to consultation responses and further thinking, is an intra-year revision to tariffs by GDNs. The LRSPs would continue to be paid directly by GDNs, as we do not consider it proportionate to revise existing approved SoLR claims such that they are paid by both GDNs and IGTs. To avoid GDNs over-recovering, GDNs would revise their 2022/23 tariffs by end of July, effective from 1 October 2022. As set out in Ofgem's recent consent, IGTs would pay the GDNs for the LRSP costs relating to the customers connected via an IGT network, £35 per year per domestic customer.

GDNs would be required to seek Ofgem's permission to revise tariffs within-year, effective from 1 October 2022. Our current thinking is that we would be strongly minded to approve such a request. We do not believe this option would require a change in the GDNs' or the IGTs' licenses, but should we proceed with this option we would propose to revise and consult on the Regulatory Instructions and Guidance (RIGs) to make it clear that the money received by GDNs from IGTs should be treated as revenue for regulatory reporting purposes.

We do not believe that option 1 has any tax or accountancy implications. It is not Ofgem's intent to expose networks to any additional tax or to have financial reporting issues as a result of this approach and we welcome feedback and discussion on the tax implications of this, our currently preferred, option.

Interim option 2 - Both GDNs and IGTs to pay money to the SoLR

Under this option GDNs would pay the SoLR for the share of LRSP claims relating to customers connected directly to the GDN networks. IGTs would pay the SoLR for the share of LRSP claims relating to customers connected via an IGT network.

Reasons for considering and consulting on option 2

This option would remove any concerns GDNs may have relating to the accounting and tax concerns relating to the receipt of money from IGTs.

The GDNs' proposal is for LRSP claims to be revised, and around 10% of the claim to be allocated to IGTs and paid directly by them. Both GDNs and IGTs would pay the LRSP claims to the SOLRs, and there would be no payment between GDNs and IGTs.

As with Option 1, GDNs would be required to seek Ofgem's permission to revise tariffs within-year, effective from 1 October 2022. Our current thinking is that we would be strongly minded to approve such a request. GDNs would revise their 2022/23 tariffs by end of July.

Advantages and disadvantages of option 2

Our current understanding is that option 2 would have the advantage that it would avoid any possible tax concerns expressed by GDNs.

On the other hand, option 2 would involve licence modifications to Standard Licence Condition 48 for IGTs and possible A48 for GDNs, subject to the appropriate consultations. It would also involve revisions to already approved LRSP claims and a detailed set of re-profiled LRSP payments to ensure the correct flows of money. All of these changes would require extensive consultation with networks and suppliers.

Interim option 3 – GDNs to lower 2023/24 tariffs, instead of adjusting 2022/23 tariffs

This option is similar to Option 1, but involves GDNs lowering 2023/24 tariffs instead of adjusting 2022/23 tariffs within-year. GDNs would continue to pay the LRSP claims to SoLRs, but IGTs would pay the GDNs for their share of LRSP costs. GDNs would over-recover for 2022/23 and their 2023/24 tariffs would reflect any money received from IGTs during 2022/23.

Whilst the GDNs would not be required to ask for consent to revise 2022/23 tariffs, the GDNs may ask for the penal rate of interest to be waived for any over-recovery associated with IGT payments.

Advantages and disadvantages of option 3

An advantage of option 3 would be that GDNs would not need to revise their tariffs for 2022/23.

There are two disadvantages of option 3. Firstly, GDN customers would not benefit from the lower charges in 2022/23, having to wait until 2023/24. Secondly, there would be an inconsistency in charges between customers connected via an IGT network and those connected directly to a GDN network. Ofgem gave consent to IGTs to charge £35 pa per domestic customer for 2022/23 under the assumption that GDNs would revise their 2022/23 tariffs mid-year. If the GDNs delayed revising their tariffs until April 2023, existing GDN SoLR charges would remain unchanged at around £38 pa, whilst the charge levied by IGTs would be 10% lower at £35.

Enduring solution from 2023/24

Our preferred enduring solution for network charges from 2023/24 onwards is for a new Uniform Network Code (UNC) modification to be proposed which would allow an GDN to recover an LRSP charge from all customers, including those connected via an IGT, rather than just its own customers. As per the current arrangements, Ofgem would be responsible for apportioning the LRSP costs between domestic and non-domestic customers. The LRSP claims would continue to be paid only by GDNs, rather than expanding the scheme to oblige IGTs to pay a SoLR directly.

Whilst our current preference is for LRSP claims to be paid directly only by GDNs, we welcome views on the advantages and dis-advantages on reforming the LRSP process for future claims such that it involves payments by IGTs in addition to GDNs, or involves payments exclusively by National Grid Gas.

Next steps

We would appreciate responses to the proposals made in this open letter by Wednesday 18 May 2022.

If you have any questions regarding this letter, please contact Andrew Ryan (Andrew.Ryan@ofgem.gov.uk) in the first instance.

Yours sincerely,

Andrew Ryan
Head of Regulatory Finance Policy