

David Hall
Deputy Director of Financial Resilience and Controls
Ofgem
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London
E14 4PU

5 April 2024

Dear David,

SUPPLIER OF LAST RESORT LEVY OFFSET

We welcome the opportunity to respond to your consultation on the Supplier of Last Resort (SoLR) levy offset proposal. This response reflects the views of our licensed supply business ScottishPower Energy Retail Limited (SPERL). Our networks business, SP Energy Networks (SPEN) is responding separately via the ENA.

Our responses to the stakeholder questions are in Annex 1 to this letter. We would like to highlight the following points:

- We agree with Ofgem on the importance of reducing the costs faced by consumers, and are pleased that Ofgem is considering a range of approaches to limit consumers' exposure to the costs of supplier failure.
- However, we are concerned that the impact on supply markets of the SoLR levy offset proposal has not been fully worked through. More transparency about the expected benefits and risks of these reforms would be appreciated.

Yours sincerely,



Richard Sweet
Director of Regulatory Policy

SOLR LEVY OFFSET - SCOTTISHPOWER RESPONSE

Q1. Do you agree with our problem statement?

We agree that potential fairness and consumer impact issues have been identified, as set out in paragraphs 2.11 to 2.15 of Ofgem's consultation document - which can be summarised as an acknowledgement that it is possible that shareholders may benefit from any surplus value of a failed supplier's assets while said failure imposes significant costs on consumers.

However, the materiality of the problem is not clear from the consultation document. There is insufficient information to indicate whether the benefits of the proposed solutions might reasonably be expected to outweigh the costs of implementation and increased ongoing complexity.

Q2. What are your overall views on whether the proposal would deliver on the aims of the SoLR levy Offset?

The SoLR Levy Offset mechanism aims to reduce the impact on consumers of supplier failure, by reducing the level of mutualised costs, as well as improving the fairness of the SoLR levy mechanism (para 2.16).

The proposals seem broadly sensible in terms of framing the problem for further analysis, however it is not clear whether a significant reduction in the level of mutualised costs can reasonably be expected, or to what extent Ofgem has carried out work to quantify this. We do recognise that Ofgem will continue to explore the impact on consumers as the work develops (para 5.5).

Q3. What are your views on the proposed option of network companies being creditor, as opposed to other alternatives.

Ofgem considers that creating a debt due to the network companies is the most effective method to implement its proposals because:

- Distribution network companies are already involved in the process, as SoLRs submit claims to them up to the amount that Ofgem has consented to; and
- Distribution networks have a level of continuity, in that the number and identities of the network companies do not change frequently.

The alternative parties that Ofgem considered as potentially suitable were the appointed SoLRs, the transmission network companies, the Future System Operator (FSO) and Ofgem itself. The assessment of the appropriate party to take on the role of creditor was based on two key principles:

- The need for claims to be clear for the purpose of administration/liquidation; and
- Ofgem's duty to carry out its functions in a manner best calculated to promote economy and efficiency on the part of all licence holders.

Ofgem considers that making the FSO the creditor for the SoLR Levy Offset would raise similar issues as set out for transmission network companies:

- Under the current process, this would be an additional step and the amount recovered would need to be returned to the distribution networks in order for it to be passed to customers.
- “Significant work” would be needed to recast the SoLR Levy away from distribution, requiring consideration of the impacts that putting the SoLR Levy through transmission charges might create.

Since the FSO is still in development, Ofgem also raises a concern that “it is difficult to assess how this role might fit with its composition.” The FSO, in the form of the National Energy System Operator (NESO) is due to go live in summer 2024. We think that this timing of this could work well as it could be included in industry engagement to refine roles and responsibilities.

Ofgem has a role in providing oversight in ensuring the FSO is sufficiently resourced and has the skills and capabilities to deliver its objectives. We suggest that Ofgem reconsiders the possibility of the FSO being creditor and recovering the money through TNUoS. An assessment of the impacts here should be relatively straightforward.

Q4. What are your views on the creditors ranking in the insolvency waterfall as unsecured creditors and do you think another classification would be more appropriate?

Ofgem’s proposed ranking of networks as unsecured creditors is based on its intent not to disrupt secured credit which could impact the associated cost of capital. It considers that network companies ranking as unsecured creditors would limit negative effects while allowing the prospect of offsetting some of the costs of the SoLR levy claim. The main adverse impact (other than on shareholders) will be on other unsecured creditors, whose ability to recover sums from an insolvency may be severely diluted, and this could therefore increase the perceived credit risk of the supplier. On balance this seems a broadly sensible proposal.

Q5. What are your views on the creditor claim being contingent on a valid claim being made by a SoLR for a LRSP? Do you think that the creditor claim could be formulated or calculated in another way?

We agree with the arguments presented that the creditor claim should be contingent on a valid claim being made by a SoLR for a LRSP.

Q6. What are your views on the deed as it is currently drafted?

We do not have substantial comments on the deed at this time. We are still considering whether the deed would give rise to any issues from a financial perspective and will advise Ofgem if we identify any concerns.

Q7. What are your views on the proposed license changes for suppliers and networks? Please identify any factors relating to the drafting of license changes that we should consider at this stage.

We would be happy to provide views on the proposed licence condition when there is more clarity on how this could work. We understand that, if this work proceeds, Ofgem intends to share draft changes to licence conditions in advance of the statutory consultation stage to

ensure there is sufficient time for preparatory work and to make any required changes. We welcome this and consider it to be important to effective engagement.

Q8. Have we identified the key impacts, risks and benefits of the SoLR Levy Offset, and are there any impacts we should give further consideration to? Do you think that overall this would be of benefit to consumers?

As noted above, there is not enough information provided to assess whether the proposals would be of overall benefit to consumers. In the interests of transparency, we ask Ofgem to publish any work that has been done to assess the materiality of the costs and benefits that have been identified and the risks associated with unknown liabilities between industry participants. Consideration of the potential for the proposed changes to affect the SoLR bidding process will also be key.

ScottishPower
April 2024