

All interested stakeholders

[Licensing@ofgem.gov.uk](mailto:Licensing@ofgem.gov.uk)

Date: 7 September 2018

Dear colleague

### **Statutory consultation on modifications to SoLR supply licence conditions**

On 13 June we<sup>1</sup> consulted on changes to the supply licence conditions that underpin the Supplier of Last Resort (SoLR) arrangements, principally the process for making a claim for a Last Resort Supply Payment (LRSP). We received twenty responses to this consultation from a range of stakeholders and are grateful to respondents for providing their views.

Our proposed changes seek to enable a potential SoLR to recover costs associated with honouring credit balances for customers who have switched away from the failing supplier at the date the supplier fails. We also proposed a range of other changes to both ensure any claim for credit balances represents the actual amounts owed to customers by the failed supplier and provide appropriate flexibility in the timings for the process for making a claim.

Having carefully considered all comments (which are summarised in the appendices to this letter), we continue to consider our proposed changes are appropriate, and are now proceeding with a statutory consultation on the proposed licence changes. The appendices to this letter cover the following areas:

- **appendix 1** – comments on our proposed changes and our view on these
- **appendix 2** – overview of our draft licence changes and amendments we have made in light of comments we have received

Alongside this document we have published draft licence modification Notices for both the gas and electricity licences. Stakeholders have until 8 October to respond to this statutory consultation and can send views to [licensing@ofgem.gov.uk](mailto:licensing@ofgem.gov.uk). If we decide to make the proposed modifications they will take effect not less than 56 days after the decision is published.

Yours sincerely

**Lesley Nugent**  
**Head of Industry Codes and Licensing, Ofgem**

<sup>1</sup> The terms "the Authority", "we" and "us" are used interchangeably in this document.

## **Appendix 1: comments on our proposed changes and our view on these**

### **Proposed licence changes to enable potential LRSP claims to include “closed-account” credit balances**

#### *Our proposal*

1. We proposed amendments to SLC 9.4 to clarify that the SoLR could (if appropriate) seek to recover the costs of protecting all affected customer credit balances through the Last Resort Supply Payment (LRSP). Including the costs associated with honouring credit balances for domestic customers who have switched away from the failing supplier at the date the supplier fails (closed credit balances).
2. We set out that our proposed change will ensure that we continue to have effective “safety net” protections in place for customers in the event that a supplier of last resort is appointed.

#### *Stakeholder feedback*

3. The majority of respondents supported our proposed change; a small number did not express a view, and some respondents offered qualified support. For example, one respondent welcomed the proposal and considered the change is right in principle, but questioned if they would be workable. Another respondent stated they are generally supportive of the proposed modifications but only if other regulations on market entry are taken forward in parallel. One respondent did not give an opinion on the proposed change and considered that it would be more appropriate for Ofgem to take steps to minimise the number of SoLR events in the future.

#### *Our view*

4. We welcome that the majority of respondents gave outright support and no respondent explicitly disagreed with our proposal. We intend to proceed with our proposed licence changes, as we continue to consider they are appropriate to ensure that we have effective safety net arrangements in place.
5. For the avoidance of doubt, it is still our preference for a SoLR not to make a LRSP claim. Our proposed changes would only apply in the scenario where the SoLR had not waived their right to make a LRSP claim, as part of the SoLR selection process. As set out in our SoLR guidance<sup>2</sup> we consider each LRSP claim on a case-by-case basis and will only approve a claim if it is appropriate in the circumstances of the case.
6. Regarding the comments that Ofgem should take forward work to reform our approach to market entry, as stated in our Open Letter published on 11 June 2018<sup>3</sup>, we are reviewing our approach to licensing suppliers and intend to consult on our proposals in late summer.

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<sup>2</sup> [https://www.ofgem.gov.uk/system/files/docs/2017/09/solr\\_revised\\_guidance\\_final\\_21-10-2016.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/09/solr_revised_guidance_final_21-10-2016.pdf)

<sup>3</sup> [https://www.ofgem.gov.uk/system/files/docs/2018/06/consultation\\_licence\\_changes\\_solr.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/06/consultation_licence_changes_solr.pdf)

## **Proposed licence changes to limit the costs a SoLR may recover for protecting credit balances to avoid risk of inaccurate and inappropriate cost recovery**

### *Our proposal*

7. We proposed new definitions in SLC 9.10, to clarify that any costs which a SoLR may recover for protecting credit balances (as permitted by our proposed amendment to SLC 9.4) are limited to the actual amounts owed to customers by the failed supplier, taking into account any unbilled gas and electricity consumption.
8. We stated that this change will help ensure that any claim for credit balances:
  - a. takes account of consumption that has not been billed for at the date of the SoLR's appointment; and
  - b. represents the net position of the customer across both gas and electricity.

### *Stakeholder feedback*

9. The majority of respondents did not provide a view on this specific aspect of our proposed changes. One respondent raised concerns that our proposal would be overly burdensome for the SoLR given they may not have sufficiently clean data on which to calculate the net credit balance position for each customer. They stated this would be particularly the case if the SoLR does not get access to the failed supplier's customer and meter data, and systems.
10. Another respondent was concerned that our definition of "Credit" was too narrow and precluded payments – such as goodwill payments – to the consumer that were made or would have been made had the supplier not failed. They also highlighted that there can be instances where a credit balance is in dispute and the case is under review with a third party (either the Ombudsman or the Extra Help Unit). They asked that our supply licence review looks at such situations and provides greater clarity on how open cases should be handled.

### *Our view*

11. We intend to proceed with our proposed licence changes which we believe should ensure that any claim for credit balances represents an accurate aggregate credit position of each of the customers in question, as far as possible.
12. With regard to the concern raised about data quality, we recognise that there can be challenges in establishing the credit position, depending on the particular circumstances. Nevertheless, we consider that it is essential that a SoLR takes all reasonable steps to establish an accurate position, in order that any related claims are minimised and reflect as far as possible accurate costs. To this end, where we are able to, we provide the SoLR with appropriate information.
13. Regarding the comments on goodwill payments and credit balances in dispute, we recognise the importance of ensuring impacts on individual customers are minimised and consider these issues can continue to be considered by an incoming SoLR, in conjunction with consumer bodies and Ofgem as required, on a case by case basis. We do not think there is a need to seek to make explicit provision in the licence conditions themselves in relation to these issues.

## **Proposed licence changes to give greater flexibility to the SoLR to make a LRSP claim and to the Authority to decide on any claim**

### *Our proposal*

14. We proposed a series of amendments to provide both the SoLR and the Authority greater flexibility to make and decide on a claim for a LRSP. These were:
  - Deleting text in SLC 8.2(b) to remove the sunset provision that a Last Resort Supply direction ceases to have effect six months after the date on which the direction takes effect
  - Amending SLC 9.3 to move the deadline for submitting a claim from no later than 6 months from the date the Last Resort Supply Direction stops having effect (ergo 12 months after the SoLR event) to a date notified by the Authority or 5 years if no date is given
  - Deleting text in SLC 9.6 to remove the three month deadline on Ofgem by which we need to determine if a different amount to that submitted by the SoLR.
15. We set out that these proposed changes should ensure that the timings in the licensing framework provide flexibility to enable a SoLR to seek to recover any costs it incurred in protecting customer credit balances through the liquidation of the failed supplier in the first instance, to reduce the amount of any potential LRSP claim. These changes should also help to ensure that any claim accurately reflects the additional costs the SoLR actually incurs, rather than relying upon estimations.

### *Stakeholder feedback*

16. Responses to this proposal were mixed. Six respondents either gave full or qualified support for our proposals. They particularly highlighted the need for greater flexibility. Although one of these respondents asked for more detail on our rationale. Nine respondents did not provide a view. One respondent considered that five years should not become the *de facto* time frame for the submission of a LRSP claim.
17. Three respondents raised concerns and stated either disagreement with the five year backstop limit or stated they wanted costs to be recovered more quickly. Of these respondents, one said the move to a five year deadline was not justified in the consultation document and called for an impact assessment so that the unintended consequences of this change can be investigated.
18. One respondent considered that a five year limit increases the risk of double recovery of costs through both liquidation and the LRSP. In addition a number of respondents considered that the move to a five year backstop would have the unintended consequence of making volunteering to be the SoLR unappealing given the difficulties this could present to suppliers in managing cash flow.
19. Two respondents also raised concerns with removing the three-month deadline on the Authority to make a decision following the submission of a claim. One stated that they understood the rationale for removing this deadline restrictions but called for it to be replaced with a longer backstop.

## *Our view*

20. We welcome all responses received on these proposed changes. We continue to consider that the proposed changes are appropriate and among other things should, by introducing appropriate flexibility, help minimise LRSP claims. We do recognise a number of respondents do not agree and have raised concerns, and we address these points below.
21. Our experience from considering the first claim for a LSRP is that the 12-month deadline for a claim can be unduly restrictive. In particular, it is uncertain whether the liquidation process would be completed within a year of a SoLR event. This means that it would be likely that a SoLR could not take into account monies (if any) received through the liquidation process, at the time of making its claim to Ofgem. This can result in a need for any amount we consent to being claimed, being conditional and being revisited at a later date. This may potentially result in the need for further adjustments to network charges (and revenue allowances), should the SoLR subsequently have to return to gas and electricity network operators payments they have received as a result of their claim. We consider that this results in unnecessary complexity and uncertainty for industry. By removing this deadline it enables a SoLR to try to recover their costs through the normal liquidation process in the first instance.
22. We note one respondent considered that an impact assessment should be carried out, to consider potential unintended consequences of our proposed change. The proposed change is intended to allow for flexibility, where appropriate, where this would be expected to allow for a lower cost outcome overall. As such, we would consider the impacts of the timing of a claim on a case-by-case basis.
23. With regard to stakeholders' concerns that five years is too long a period to wait to make a claim, we note that this is a backstop and it is not our expectation of when a claim will be made. As the proposed new drafting states, five years will only become the deadline if the Authority does not propose an earlier date.
24. On the related concern regarding the removal of the three-month deadline by which the Authority must consent or propose an alternative figure for a claim, we note that we will always endeavour to come to a view on any claim as quickly as possible. As in the case with Co-Operative Energy's claim, this may be done in less than three months. However we consider it is appropriate and in consumers' interests to provide flexibility, should it be needed, to ensure that the Authority is not unduly time-constrained in coming to a view on the appropriateness of a LRSP claim.
25. With regard to the risk of double recovery of costs, we do not consider that lengthening the deadline to submit a LRSP claim will exacerbate this risk. As is the case today, we will continue to expect all costs that make up a LRSP claim to be fully justified and proven to have been reasonably incurred and not otherwise recovered.

**Proposed licence changes to allow recovery of costs from all customers rather than those in the geographic areas in which the premises supplied by the failed supplier were**

*Our proposal*

26. The licence currently sets out that a supply licensee may make an LRSP claim (subject to our consent) from any relevant Distribution licensee “in whose Distribution Services area were premises supplied by the licensee under the Last Resort Supply Direction”. We proposed to remove this text, as we consider it is not necessary nor in the interests of consumers as a whole to link recovery of SoLR-related costs to the geographic area where customers of a failed supplier happened to be located. We stated that as our SoLR arrangements protect consumers overall, including by ensuring ongoing trust and confidence in the retail market, it is more appropriate that such costs can be recovered from all consumers.

*Stakeholder feedback*

27. Seven respondents supported this change and thirteen did not give a view. One respondent accepted that there are benefits to our proposed change but stated the geographic area should still be a consideration when allocating the costs of a LRSP. This is because the failed supplier may have focused their operations in one area and offered a tariff and/or service there that consumers in other geographic areas could not access. This respondent also argued that elements of a LRSP claim that pertain only to each respective fuel should be apportioned solely to gas and electricity customers respectively rather than socialised across all consumers.

*Our view*

28. We continue to believe that, as our SoLR arrangements protect all consumers and support ongoing trust and confidence in the retail market, costs of an approved claim should be recovered equally across all consumers. Our changes to SLC 9.1 do not dictate how the cost of LRSP should be allocated across electricity and gas consumers.

**Unintended consequences and other comments**

29. We also asked stakeholders for their view on unintended consequences that our changes might cause, we summarise these and other comments that stakeholders made below.

Unintended consequences

*Stakeholders’ views*

30. Some respondents argued that extending the timeframe in which a SoLR can make a LRSP claim would make it unappealing to bid to be a SoLR. Respondents also said extending the timeframes as proposed would exacerbate an existing risk that there is a lack of regulatory oversight of the liquidation process. Four stakeholders argued for wider use of the Energy Supply Company administration process to mitigate this risk.
31. One respondent said that another risk of extending the timeframe for making a LRSP claim is that it would increase the costs of capital for a SoLR. They argued

that the licence drafting needed to be broader to allow the SoLR to claim back these costs regardless of how they financed them.

*Our view*

32. As stated above we consider that a more flexible LRSP process would allow the SoLR to exhaust the liquidation process of the failed supplier in the first instance and take account of this in their claim, thereby reducing uncertainty. We accept that the liquidation process can present challenges and should a SoLR conclude that it would be in the interest of consumers to submit a claim before the liquidation process was complete, we would consider this representation taking into account all circumstances of the case. We do not consider it necessary, at this time, to review the conditions when we may consider using the Energy Supply Company Administration process, which is intended to be used only in the unlikely scenario that a large supplier becomes financially distressed.<sup>4</sup>
33. We consider that the licence drafting is sufficiently flexible to allow a SoLR to claim for the costs of capital (directly related to their role) regardless of how they accessed this capital. As is the case today, the Authority will only allow this cost if the SoLR made the case as to why it is appropriate in all circumstances of the case.

*Other comments made by stakeholders*

34. Eight respondents raised issues and concerns with regards to our SoLR process and approach to licensing suppliers. Many called for the barrier to market entry to be raised and for tougher ongoing mandatory monitoring of suppliers. A subset of these respondents also called for stricter regulations to protect consumers against risky business models or for certain models, such as payment in advance, to be banned outright.
35. Five network operators raised a range of issues with the process for recovering the cost of any LRSP through the existing industry arrangements.

*Our view on these*

36. As we stated in our consultation we are now reviewing our approach to licensing suppliers. We are grateful to respondents for providing their views on this area; this is a helpful input as we develop our proposals. We intend to consult on our initial proposals on changing the licensing regime in the coming weeks.
37. We are also grateful to the network operators who set out in detail the issues surrounding the mechanics of how industry passes through the costs of a LRSP. We are aware of these and are working with colleagues across industry to resolve them.

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<sup>4</sup> DECC consultation on energy supply company administration rules:  
[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/183983/consultation-energy-supply-company-admin.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/183983/consultation-energy-supply-company-admin.pdf)

## Appendix 2: proposed amendments to our draft licence changes

SLC	Proposer	Proposed change	Proposer's rationale	Our view and rationale
1.3 Relevant Distributor	Network operator	in relation to any premises, means, except in standard condition 15 (Assistance for areas with high distribution costs scheme: payments to System Operator), the Licensed Distributor to whose Distribution System those premises are connected and in whose licence Section B has effect;	Section C of the distribution licence no longer exists	Agree  Housekeeping change
8.2(b)	Large supplier	The Last Resort Supply Direction will: (b) stop having effect on and from a date, specified in the Last Resort Supply Direction, that is up to [six months] after the date on which the direction has effect;	Ofgem should retain a back-stop date for when a Last Resort Supply Direction should cease to have effect	Disagree  Consider 5 years is a backstop. Also as a LRSP claim is no longer anchored to Last Resort Direction there is no need to put a sunset clause on the Direction.
9.3(b)	Large supplier	b) give the Authority a calculation of the amount claimed with information to support that calculation, no later than a date notified to it by the Authority or, in the event that no such date is notified, five years after the date on which the Last Resort Supply Direction to which the claim relates takes effect.	Related to the above, the proposal is to mitigate the risk of very extended periods of time for a claim to be made by linking the five year back stop date to the date the Last Resort Supply Direction takes effect rather than a date five years after the Direction ceases to have effect.	Disagree  Do not expect 5 years after becoming the SoLR to become the de facto time frame of a LRSP claim.
8.2(c)	Large supplier	where the other supplier is a Green Deal Licensee and is supplying Green Deal Premises, ensure that those Green Deal Premises will continue to be supplied by a Green Deal Licensee.	Fix to a typographical error.	Agree  Housekeeping change. We have also made similar changes to 8.4(b)
9.1	Large supplier	Exact change not provided but suggested adding in text that would mean costs for	Cost of SoLR process should be borne across all consumers	We do not think that a potential licence change to



		Supply Resort Payment would be recovered from iDNOs/iGTs.		address this comment is within scope of this consultation. But we agree this issue could be further considered, as part of the separate, ongoing work considering potential changes to the cost recovery mechanism.
9.4	Large supplier	The total amount of the Last Resort Supply Payment (for this condition only, "the relevant amount") to be claimed by the licensee must not exceed the amount by which: (a) the total costs (including <del>interest on working the associated cost of capital</del> ) reasonably incurred by the licensee in supplying electricity to premises under the Last Resort Supply Direction and a reasonable profit, plus (b) any sums paid or debts assumed by the licensee to compensate any Customer in respect of any Customer Credit Balances ( <del>and the associated cost of capital</del> ),	Current drafting too restrictive.	Disagree  Licence, as is, doesn't prohibit these costs and requires the Authority to consider the appropriateness in all the circumstances of the case of permitting recovery of all sums claimed.
9.6	Large supplier	Exact change not provided but suggested a deadline for LRSP claims to be included in the licence.	To provide certainty to other suppliers	Disagree  Consider it is appropriate and in consumers' interests to provide flexibility in the process to allow SoLR to take into account monies (if any) received through the liquidation process and to

				ensure that the Authority is not unduly time-constrained in coming to a view on the appropriateness of a LRSP claim.
SLCs 8 and 9	Large supplier	Exact change not provided but suggested greater clarification is made with regards to whether the licence conditions apply to domestic and microbusiness consumers	Would aid understanding of scope of SoLR arrangements	We are not considering any further changes in relation to this comment at this time but we will keep this under review should further clarification be necessary.
9.10	Large supplier	means any Credit owed, on the date on which a relevant Last Resort Supply Direction takes effect, by the other supplier to any Customer for whom the responsibility for the supply of electricity had <b>either</b> transferred from the other supplier to another Electricity Supplier or had otherwise terminated at or before the date on which the relevant Last Resort Supply Direction takes effect	Aid clarity of our definition of Closed Credit Balances	Agree  Housekeeping change