



Making a positive difference
for energy consumers

Gas and electricity suppliers, gas transporters, electricity distributors and all other interested parties

Licensing@ofgem.gov.uk

Date: 13 June 2018

Dear colleague

Proposed modifications to SoLR supply licence conditions

We recently published an open letter setting out the scope and objectives of the review of our approach to licensing suppliers, to ensure that appropriate protections are in place against poor customer service and financial instability.¹ Our letter highlighted that we would consider the current licensing arrangements for supply market entry², as well as exit and ongoing operation and monitoring as part of our review. We also stated that we would seek to implement any proposed changes in a phased fashion, to ensure that beneficial changes to protect consumers are in place as soon as possible.

Our first step is to consult on a number of clarifications to the supply licence conditions that underpin the Supplier of Last Resort (SoLR) arrangements. In particular, the proposed changes would:

- clarify that a SoLR could (if appropriate) seek to recover the costs of protecting all affected customer credit balances – both balances held by the failed supplier's existing customers and balances not yet reimbursed to its former customers;³
- clarify the limitations on costs of protecting customer credit balances that can be claimed, to avoid risk of over and/or inappropriate cost recovery;
- provide greater flexibility in the licensing framework on the timings of potential claims for SoLR related costs; and
- make housekeeping changes to tidy up the existing drafting of the conditions.

We are seeking responses to the proposed changes set out in this letter by 11 July 2018. Following this, if we decide to take forward the licence modifications set out in this letter, we will issue a statutory consultation as soon as practicable. The proposed clarifications will ensure that we continue to have effective "safety net" protections in place for customers in the event their supplier exits the market.

¹https://www.ofgem.gov.uk/system/files/docs/2018/06/180611_supply_licensing_review_open_letter_for_publication.pdf

² Our review will cover only those arrangements we are responsible for through licensing, and will not consider the detailed industry code rules related to market entry.

³ The current licensing provisions already allow a SoLR to recover the costs of protecting credit balances held by *existing* customers, if appropriate.

Proposed licence changes to enable potential SoLR claims to include 'closed-account' credit balances

From time-to-time, a supplier in the competitive retail market may fail. Not all instances of supplier failure will require regulatory intervention, however we have powers to act if they do, in order to minimise wider market impacts and to protect consumers. This includes our powers to appoint a SoLR for the customers of a failed supplier.

In order to get the best outcome for consumers, we undertake a competitive process to identify a SoLR to take on the customers of a failed supplier. We consider a broad range of factors in deciding which supplier to appoint as the SoLR. Among other things, we ask suppliers whether they expect to make a claim under the "backstop" industry arrangements that enable a supplier to recover the additional costs of being a SoLR, subject to our consent. If we consent, the costs are recovered through gas transporters' and electricity distributors' charges for using the networks.

In October 2016, we published revised guidance on SoLR and energy supply company administration orders.⁴ We stated that when selecting a SoLR, we would normally give preference to those suppliers who commit to protect any customer credit balances and to those who state that they will not make a claim via the industry arrangements for last resort supply payments, but that we may depart from this depending on the specifics of the supplier insolvency. In many circumstances, an efficient SoLR could be expected to be able to cover its own costs and not rely on additional industry payment, however there may be occasions in which this would not be possible and they may seek to recover some of their costs.

Generally, we expect suppliers that volunteer to be a SoLR to offer to cover all or the majority of the associated costs and to honour any credit balances customers may hold.⁵ This reflects the value that they will obtain through being appointed the SoLR, through the expansion of their customer base. Presently, the industry arrangements do not enable the 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 consider it would be appropriate for the arrangements to allow SoLRs to be able to recover all relevant costs (where appropriate) via the backstop cost recovery mechanism (subject to our consent) and are proposing changes to the licence conditions to enable this. Our proposed licence drafting is set out in Annex 1, and explained in more detail in Annex 2.

Our proposed changes clarify, for the avoidance of doubt, that any costs which a SoLR may recover for protecting credit balances are limited to the actual amounts owed to customers by the failed supplier, taking into account any unbilled gas and electricity consumption. In addition, when assessing a claim for reimbursement of such costs, we would expect the SoLR to minimise any payment from the industry by claiming the cost of honouring customer credit balances from the failed supplier's liquidation, whenever possible.

For the avoidance of doubt, our preference continues to be for a SoLR to waive their right to make a claim under the levy. Where a licensee does not waive their right, we would expect them to minimise the expected size of any potential claim.⁶ We will consider any claim under the levy on a case-by-case basis, and decide whether any claim was justified taking into account all the circumstances of the case.

⁴ https://www.ofgem.gov.uk/system/files/docs/2017/09/solr_revised_guidance_final_21-10-2016.pdf

⁵ While there is no obligation for a SoLR to honour credit balances of former customers, we would take any commitment to do so into account when selecting a SoLR and to date balances have been honoured.

⁶ Although we recognise that the circumstances of a specific supplier failure may justify a SoLR making a claim, an efficient SoLR should be able to minimise its exposure to these costs.

Other changes

We have also identified a number of other proposed clarifications to the SoLR related licence conditions within the supply licences, which are set out in Annex 1:

- Currently, the licence conditions set out that a Last Resort Supply direction will cease to have effect within six months; separately, the licence also requires a licensee to submit a claim under the levy within six months of the Last Resort Supply direction ceasing to take effect. We have proposed changes to these provisions, to ensure that the timings in the licensing framework provide flexibility to enable a licensee to seek to recover any costs it incurred in protecting customer credit balances through the normal administration process in the first instance, to reduce the amount of any potential industry claim.
- The licence currently sets out that a supply licensee may make an industry 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 are proposing to remove this text, as we consider that it is not necessary or 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. In general, given that our SoLR arrangements protect consumers overall, including by ensuring ongoing trust and confidence in the retail market, we consider it is more appropriate that such costs can be recovered from all network users. This change should mean that the cost of SoLR processes are borne more evenly across the industry and that no market participant is subject to a disproportionate charge based on geographic region.
- We have proposed minor housekeeping changes, for example to correct the reference to the related Distribution licence provisions that the supply licence conditions refer to.

We recognise it may be appropriate to consider further changes to the SoLR related licence conditions, including in relation to the issues with the mechanics of last resort supply payments discussed in our January 2018 decision to consent to Cooperative Energy Limited making a claim under the levy.⁷ Some of this work will appropriately be considered by industry, for example through relevant network charging groups. As set out above, our supplier licensing review will also be considering supplier exit arrangements more broadly.

We have included in Annex 1 to this letter a marked-up version of potential changes to the legal drafting of standard conditions 8 and 9 of the gas and electricity supply licences, to give effect to the changes proposed in this letter.⁸ We have included in Annex 2 an overview of the proposed changes and their effect.

Next steps

We welcome views from respondents on the proposed licence modifications, in particular:

⁷ https://www.ofgem.gov.uk/system/files/docs/2018/01/last_resort_supply_payment_claim_from_co-operative_energy_final_decision.pdf

⁸ The legal drafting in the Annex is from the standard conditions of the electricity licence only. Should we decide to proceed with these proposed changes, we would consult on equivalent to changes to both the electricity and gas standard licence conditions.

1. Do you agree with the intent of the proposed changes?
2. Do you agree that the draft licence changes deliver the intent?
3. Do you consider there are any potential unintended consequences of the proposed changes that we have not identified?
4. Do you have any comments on the proposed licence drafting, set out in Annex 1?

Responses should be sent by **11 July 2018** to: Licensing@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.

If, following consideration of respondents' views, we decide to proceed to modify the licences, we will issue a statutory consultation as soon as practicable following our review of the consultation responses.

Yours sincerely,

Lesley Nugent
Head of Industry Codes and Licensing, Ofgem

Annex 1: Draft proposed licence changes⁹

Condition 8. Obligations under Last Resort Supply Direction

Last Resort Supply Direction

- 8.1 The Authority may give a Last Resort Supply Direction to the licensee if it considers that:
- (a) a circumstance has arisen that would entitle it to revoke the Electricity Supply Licence of an Electricity Supplier other than the licensee (for this condition and condition 9 of this licence only, the “other supplier”); and
 - (b) the licensee could comply with the Last Resort Supply Direction without significantly prejudicing its ability:
 - (i) to continue to supply electricity to its Customers’ premises; and
 - (ii) to fulfil its contractual obligations for the supply of electricity.
- 8.2 The Last Resort Supply Direction will:
- (a) have effect on and from the date on which and the time at which the other supplier’s Electricity Supply Licence is revoked;
 - (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;~~ and
 - (c) 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.

Licensee’s obligations

- 8.3 Except in the circumstances set out in paragraph 8.4, the licensee must comply with a Last Resort Supply Direction.
- 8.4 The licensee:
- (a) is not required to comply with a Last Resort Supply Direction in respect of premises to which it would not be required to supply electricity because of any of the exceptions set out in sub-paragraphs 6(a) and (b) of standard condition 22 (Duty to offer and supply under Domestic Supply Contract); and

⁹ The legal drafting in this Annex is from the standard conditions of the electricity licence only. Should we decide to proceed with these proposed changes, we would consult on equivalent to changes to both the electricity and gas standard licence conditions.

- (b) shall not comply where the Last Resort Supply Direction is in respect of a Green Deal Premises and the licensee is not a Green Deal Licensee.
- 8.5 Within a reasonable period of time after receiving a Last Resort Supply Direction, the licensee must send a Notice to each of the premises specified or described in the Last Resort Supply Direction to inform each Customer:
- (a) that the other supplier stopped supplying electricity to his premises with effect on and from the date on which the Last Resort Supply Direction had effect;
 - (b) that the licensee began to supply electricity to his premises with effect on and from the date on which the Last Resort Supply Direction had effect;
 - (c) that the licensee is supplying electricity to the Customer's premises under a Deemed Contract;
 - (d) that the Customer may enter into a Contract with the licensee or any other Electricity Supplier under which electricity will be supplied to his premises;
 - (e) of the Charges for the Supply of Electricity that the licensee may charge the Customer while supplying him under the Last Resort Supply Direction; and
 - (f) if the Customer is a Green Deal Bill Payer, a statement to the effect that the premises are Green Deal Premises and that the Green Deal Charges will be added to the charges for the Supply of Electricity notified to the Customer under paragraph (e) above.

Charges under Last Resort Supply Direction

- 8.6 The licensee's Charges for the Supply of Electricity to the premises specified or described in the Last Resort Supply Direction must not exceed an amount that may be expected, in total, approximately to equal the licensee's reasonable costs of supply (including, where appropriate, the costs of purchasing electricity at short notice) and a reasonable profit.
- 8.7 If the licensee purchases electricity to comply with a Last Resort Supply Direction, it must take all reasonable steps to do so as economically as possible in all the circumstances of the case.

Condition 9. Claims for Last Resort Supply Payment

Ability to make claim

- 9.1 If the licensee has received the Authority's consent under paragraph 9.5, it may make a claim for a Last Resort Supply Payment, under standard condition 38 48-(Treatment of Last Resort Supply: Payment Claims for Last Resort Supply) of the Distribution Licence, from each Relevant Distributor ~~in whose Distribution Services Area there were premises supplied by the licensee under the Last Resort Supply Direction.~~
- 9.2 The licensee must not make a claim for a Last Resort Supply Payment if, and to the extent that, it has waived its ability to do so by Notice given to the Authority before the Authority gave it a Last Resort Supply Direction.

Process for making claim

- 9.3 If the licensee intends to make a claim for a Last Resort Supply Payment, it must:
- (a) give Notice to the Authority of its claim; and
 - (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 ~~six months~~ after the date on which the Last Resort Supply Direction to which the claim relates stops having effect.

- 9.4 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 interest on working capital) 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,

are greater than:

~~(b)~~ (c) the total amounts recovered by the licensee through Charges for the Supply of Electricity to premises under the Last Resort Supply Direction (after taking all reasonable steps to recover such ~~e~~Charges).

- 9.5 If the Authority considers it appropriate in all the circumstances of the case for the licensee to make the claim notified to it in accordance with paragraph 9.3, the Authority will give its consent to the licensee.

- 9.6 ~~Within three months after it has been notified of the claim in accordance with paragraph 9.3,~~ the Authority may determine that an amount other than the one calculated by the licensee is a more accurate calculation of the relevant amount.
- 9.7 If the Authority makes a determination under paragraph 9.6, the amount specified by it must be treated as the relevant amount for the purpose of paragraph 9.8.

Submissions to Relevant Distributors

- 9.8 A claim by the licensee for a Last Resort Supply Payment from each Relevant Distributor referred to in paragraph 9.1 must specify:
- (a) the respective proportion of the relevant amount to be paid by that Relevant Distributor (being the same as the number of premises located within its Distribution Services Area when expressed as a proportion of the total number of premises located within the Distribution Services Areas of all the Relevant Distributors in question); and
 - (b) whether payment is to be made by quarterly or monthly instalments.
- 9.9 A claim for a Last Resort Supply Payment will lapse if the licensee does not make it within six months after the Authority has given its consent under paragraph 9.5.

Definitions for condition

9.10 In this condition:

<u>“Closed Credit Balance”</u>	<u>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 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;</u>
<u>“Customer Credit Balances”</u>	<u>means Closed Credit Balances and Open Credit Balances;</u>
<u>“Credit”</u>	<u>means an amount by which the payments made by a Customer to the other supplier under or in accordance with a Domestic Supply Contract exceeds the sum of:</u> <ul style="list-style-type: none"> a) <u>the total amount of Charges which were due and payable by that Customer to the other supplier under the relevant Domestic Supply Contract at or before the date on which the relevant Last Resort Supply Direction takes effect;</u> b) <u>the total amount of Charges relating to electricity supplied to that Customer by the other supplier at the date of the relevant Last Resort Supply Direction that</u>

	<p><u>would have fallen due and payable under the relevant Domestic Supply Contract but for that Last Resort Supply Direction; and</u></p> <p>c) <u>the sum of any amounts equivalent to those described in (a) and (b), above, either that:</u></p> <ul style="list-style-type: none"> (i) <u>were due and payable; or</u> (ii) <u>would have been due and payable but for a direction issued by the Authority under standard licence condition 8 of a Gas Supply Licence,</u> <p><u>by that Customer to the other supplier under any contract for the supply of gas to domestic premises, insofar as that sum exceeds the amounts paid by the Customer to the other supplier under a contract for the supply of gas.</u></p>
<u>“Open Credit Balance”</u>	<u>means any Credit owed by the other supplier to a Customer on the date of the relevant Last Resort Supply Direction.</u>

9.11 For the purposes of this condition, the term “licensee” in the definition of “Charges for the Supply of Electricity” may refer to either the licensee or the other supplier, or both (as the context requires).

Annex 2: Overview of proposed supply licence changes

Standard Licence Condition (SLC) Provision	Overview of proposed change
SLC 8.1(a)	Added a reference to SLC 9, as our proposed changes to SLC 9 use the term "other supplier", as defined in SLC 8.
SLC 8.2(b)	Deleted reference to Last Resort Supply Direction ceasing to have effect within up to 6 months of it being made. If appropriate, we can still include an end date in any Last Resort Supply Direction – deleting this text provides superior flexibility on the timings.
SLC 9.1	Housekeeping change, to correct the reference to the relevant Distribution licence condition.
SLC 9.1	Deleted reference to Distribution Services area in which customers supplied under a Last Resort Supply direction are located. This means that (subject to our consent) costs can be recovered from all network users, rather than only those in certain geographic locations. So, the cost of SoLR processes should be borne more evenly across the industry.
SLC 9.2	Housekeeping change, to add text to reflect that a supplier may commit to not claim for all, or a portion, of costs associated with being a SoLR.
SLC 9.3	Changes the period within which a claim can be made, from 6 months to a date notified by the Authority (or 5 years, if no date is notified).
SLC 9.4	Adds text to clarify that a claim may include customer credit balances. Introduces new defined terms in SLC 9.10, as follows:

	<ul style="list-style-type: none"> • Closed Credit Balance: under this category, a SoLR will be able to claim under the industry arrangements (with Ofgem’s consent) for the costs the SoLR incurs in honouring credit balances that had not been reimbursed by the failed supplier to its former domestic customers at the date of the SoLR process. This definition reflects a similar definition found in SLC 27.17; • Customer Credit Balances: a SoLR will be able to claim for its costs of reimbursing credit balances both to consumers who were customers of the failed supplier at the date of the SoLR process (i.e. “Open Credit Balances”) and to consumers who had been customers of the failed supplier but who had switched away at that date but whose credit balances had not been repaid (i.e. “Closed Credit Balances”); • Credit: this definition is intended to ensure that the SoLR may only claim an industry payment for reimbursing the failed supplier’s domestic customers’ actual credit balances. The purpose of each limb of the definition is as follows: <ul style="list-style-type: none"> ○ Limb (a) reflects the definition of “Credit” contained in SLC 27.16; ○ Limb (b) has been drafted to ensure that the cost of any energy consumed by a domestic customer at the date of the SoLR process but that had not fallen due for payment at that date is deducted from the customer’s credit balance; and ○ Limb (c) has been drafted to reflect the fact that dual fuel customers may have different credit/debit positions with the failed supplier in relation to, on the one hand, gas and, on the other hand, electricity. In certain circumstances, this may give rise to excessive reimbursement for the domestic customer. Any positive customer credit balance in one fuel should, therefore, be reduced by any debt the customer owed to the failed supplier in respect of the other fuel. • Open Credit Balance: this definition has been included to provide clarification that a SoLR may claim an industry payment for costs it incurs in honouring the credit balances that the failed supplier owed to consumers who were its customers at the date of the SoLR process.
SLC 9.6	Deletes reference to “within 3 months”. This provides greater flexibility on decision timescales.
SLC 9.10	See notes for SLC 9.4 (above).

SLC 9.11	New provision, to clarify that the term "licensee" in the definition of "Charges for the Supply of Electricity" may refer to either the licensee or the other supplier, or both, for the purposes of this licence condition. This definition is intended to allow the definitions introduced in SLC 9.10 to function, insofar as they refer to "Charges" levied by the failed supplier on its customers. The term "Charges" includes "Charges for the Supply of Electricity".
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