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Ofgem
10 South Colonnade
London
E14 4PU

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Dear Lesley,

PROPOSED MODIFICATIONS TO SOLR SUPPLY LICENCE CONDITIONS

Thank you for the opportunity to respond to the above consultation on Ofgem's proposals for amendments to the Supplier of Last Resort (SoLR) arrangements.

We welcome Ofgem's open letter of 11 June setting out the scope and objectives of its overall review of the approach to licensing suppliers, of which this review of the SoLR licence conditions forms a first step. We agree that it is appropriate for Ofgem to undertake this wider review of licensing to ensure that appropriate protections are in place against poor customer service and financial instability and that the review should cover the current licensing arrangements for supply market entry and exit, and ongoing operation and monitoring.

We have previously provided feedback on the licence conditions and Guidance governing the SoLR process, and we welcome Ofgem's proposed licence conditions amendments in relation to closed credit balances and recovery from all network users. However we have the following detailed comments

- We see no reason to exclude interest costs (or more generally cost of capital) in respect of funding compensation to customers in respect of credit balances. If the time between the SoLR being appointed and submitting its claim is to be extended, the associated interest costs will become more significant. The exclusion of interest payments could act counter to Ofgem's policy intent for the SoLR to spend longer trying to recover costs through the administration process.
- We think there is a potential unintended consequence of Ofgem's amendments to the timings for when a SoLR direction would end and when a SoLR must submit a claim for a Last Resort Supply Payment. We suggest Ofgem consider amending the proposed licence conditions to provide a backstop limit to the time that can elapse between a SoLR being appointed and submitting its claim so as to provide more certainty to suppliers around the timing of cost recovery via network charges.

More generally, we note that Ofgem's proposals only relate to the licence conditions, and that there is also a need to review the associated Guidance. We set out in Annex 1 our detailed comments on the proposed licence condition amendments and on areas where we would welcome further clarity in the Guidance.

Should you wish to discuss further or have any questions please contact me via the details provided or contact Rhona Peat (rhona.peat@scottishpower.com).

Yours sincerely

A handwritten signature in blue ink that reads "Richard Sweet". The signature is written in a cursive style with a blue color.

Richard Sweet
Head of Regulatory Policy

PROPOSED MODIFICATIONS TO SOLR SUPPLY LICENCE CONDITIONS SCOTTISHPOWER COMMENTS

1. Do you agree with the intent of the proposed changes?

Yes, we agree with the intent of the proposed amendments to the SoLR licence conditions.

Closed credit balances

We have previously asked Ofgem to provide greater clarity in relation to the treatment of credit balances of former customers of the failed supplier under the industry levy, and therefore we welcome the proposed amendment by Ofgem which would allow suppliers to make a claim for honouring credit balances of both existing and former customers of the failed supplier.

Recovery from all network users

We also agree that it is appropriate to allow the recovery of any successful SoLR claim from all network users rather than only from those areas which had customers of the failed supplier, and agree with the intent behind Ofgem's proposals to provide greater flexibility on the timings to ensure that SoLRs can recover costs through the administration process in the first instance.

Other matters

We provided feedback on suggested improvements to the SoLR process in our response to Ofgem's November 2017 consultation on the Last Resort Supplier Claim from Co-Operative Energy. While Ofgem's proposed licence condition amendments address one of our main points (closed credit balances), we ask that Ofgem consider the other points we raised as part of its wider review of supplier licensing, where it notes that further consideration of the SoLR process may be undertaken. These points include:

- We think Ofgem's guidance could be clearer on areas where it would consider a claim for a Last Resort Supply Payment (we set out more on this in response to Question 2 below). We also think that amendments to the structure of the request for information issued to potential SoLRs at the point of supplier failure could support this based on previous submissions.
- It would be helpful to have a better understanding of how information would be passed to appointed SoLRs, and in particular if Ofgem has a preference between the two alternative approaches for SoLRs moving customers from the failed supplier to the SoLR: the existing Change of Supply process, or replacing the failing supplier's ID with that of the SoLR in the industry systems. If there is a preference for one option over another (we note that recent SoLR events have used the latter option), having knowledge of this would support us in our preparation to ensure we can support customers as effectively and efficiently as possible.

In addition we would welcome further consideration by Ofgem of any ways it could support the SoLR in maximising costs recovered through the administration process, as our understanding from feedback from Co-op Energy in relation to their experience in the

SoLR process was that gaining information relating to up to date customer credit balances was a particularly challenging process. For example, would Ofgem have greater powers to support the SoLR in accessing data if the failed supplier's licence was revoked at a later stage?

2. Do you agree that the draft licence changes deliver the intent?

We have two points to raise around the draft licence conditions.

Changes to timescales for giving notice of a claim for a Last Resort Supply Payment

We support Ofgem's intention to enable SoLRs to take more time to recover costs through the administration process before the deadline for giving notice of their claim. We understand why Ofgem has extended the maximum time period in SLC 9.3 from six months to five years but we do not understand why Ofgem has also removed the six month limit in SLC 8.2(b) on the period for which a Last Resort Supply Direction can have effect.

The effect of making changes to both conditions is that there is no longer any back-stop limit to the elapsed time between the Direction coming into effect and the SoLR giving notice of its claim. In other words, Ofgem has unlimited discretion (by specifying the dates referred to in SCL 8.2(b) and SLC 9.3) to set this period. Whilst we understand the need for Ofgem to have a reasonable degree of discretion, we think it would be good practice to retain an appropriate back-stop limit.

We would encourage Ofgem to explain its rationale for removing the limit in SLC 8.2(b) and to consider retaining some form of backstop limit by either:

- a) retaining a back-stop in SLC 8.2b (of either the existing six months or longer if Ofgem has evidence to suggest the need for longer); or
- b) amending SLC 9.3 to link the date by when a Last Resort Supply Payment can be made to the start of the Direction and not the date the Direction ceases to have effect.

We have suggested a possible amendment to address this in response to Question 4.

Last Resort Supply Payments

As noted above, we agree with the proposed amendment to SLC 9.4 to enable costs associated with honouring closed credit balances to be included within a SoLR claim. We have two related points:

- 1) The current drafting of SCL 9.4(b) omits the words "(including interest on working capital)" which are included in SLC 9.4(a). The implication of referring expressly to these costs in 9.4(a) but not in 9.4(b) is that interest costs associated with compensating customers for credit balances cannot be included in a claim. If Ofgem is envisaging that in future a longer period may elapse between the SoLR stepping in and making its claim, interest costs will become correspondingly more significant. Indeed, the exclusion of interest payments could incentivise the SoLR to submit an early claim and act counter to Ofgem's policy intent for the SoLR to spend longer trying to recover costs through the administration process. We can see no objective reason why interest costs should be claimable in respect of 9.4(a) but not 9.4(b) and suggest that the text of 9.4(b) is amended to align with 9.4(a).

- 2) We think that the reference to “interest on working capital” in SLC 9.4(a) is unduly restrictive. The money needed to fund the SoLR’s costs (until it receives reimbursement from the DNOs) may come from debt or equity, or a combination of the two. We therefore think a more generic term such as ‘cost of capital’ should be used in the licence condition, with further restrictions added (if required) in the Guidance document. This would be consistent with the terminology used in Ofgem’s consultation on Co-Op Energy’s SoLR claim, which referred to the “cost of capital to fund credit balances”.

We have suggested some amendments to Ofgem’s draft licence condition SLC 9.4 in respect of the above, and would suggest Ofgem may also consider whether changes to its Guidance are also required, eg to clarify what factors it will take into account in deciding whether to allow a particular cost of capital claim.

3. Do you consider there are any potential unintended consequences of the proposed changes that we have not identified?

We have not identified any potential unintended consequences for the majority of Ofgem’s proposed changes.

The one area where there could be potential for unintended consequences is in relation to the proposed changes around timing set out in response to Question 2, and in particular the potential for SoLRs to be able to make a claim up to five years after the Last Resort Supply Direction has ended. This extended period of time could create additional uncertainty for suppliers in relation to future network charges. Given the limited number of SoLR events experienced to date, we think this uncertainty and risk would be low and we expect that Ofgem’s review of supplier licensing should lead to changes which ensure this remains the case.

However if we were to experience an increase in SoLR events, the combination of a number of potential claims from the industry levy could increase this risk and uncertainty to a level that could impact on suppliers. One option to mitigate this in the future would be for Ofgem to consider introducing a process whereby, at an appropriate point, SoLRs submit an indicative claim to Ofgem which would allow information to be shared with distribution network operators who could factor this into forecasts of future network charges.

4. Do you have any comments on the proposed licence drafting, set out in Annex 1?

In Question 3 we set out two areas where we think the licence conditions should be amended. Our proposed amendments are set out in the table below.

Ref	Comment and/or Suggested Amendment	Rationale
SLC 8.2b	Amend as below: 8.2 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;	As set out in our response to Question 2, we think Ofgem should retain a back-stop date for when a Last Resort Supply Direction should cease to have effect. We have retained the existing six months,

	and	<p>however Ofgem may have reasoning to suggest a longer date.</p> <p>We note that an alternative option to address this risk is set out below in a proposed amendment to SLC 9.3</p>
SLC 9.3	<p>Amend as below:</p> <p>9.3 If the licensee intends to make a claim for a Last Resort Supply Payment, it must:</p> <p>(a) give Notice to the Authority of its claim; and</p> <p>(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 steps having effect.</p>	<p>As noted above, an alternative option to mitigate the risk of very extended periods of time under which an SoLR could make a claim from the industry levy would be to link the five year back stop date to the date the Direction takes effect rather than the date the Direction ceases to have effect.</p>
SLC 9.4	<p>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:</p> <p>(a) the total costs (including interest on working the associated cost of capital) reasonably incurred by the licensee in supplying electricity to premises under the Last Resort Supply Direction and a reasonable profit,</p> <p>plus</p> <p>(b) any sums paid or debts assumed by the licensee to compensate any Customer in respect of any Customer Credit Balances (and the associated cost of capital),</p> <p>are greater than:</p> <p>(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 Charges).</p>	<p>We think that ‘interest on working capital’ is too narrow and should be replaced by a more generic “cost of capital”, with the Guidance setting out how the cost of capital would be interpreted in practice.</p> <p>We also think that the cost of capital should be capable of being reimbursed in respect of compensating customers for closed credit balances.</p>