

To electricity and gas transmission and distribution companies, generators, suppliers, offshore transmission companies, independent network operators, customer groups and other interested parties

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Date: 20 November 2018

Dear colleagues,

Informal consultation on modification to the Electricity Distribution Licence to recover the costs associated with appointing a Supplier of Last Resort

Overview

This letter invites views on proposed modification to the Standard Licence Conditions (SLCs), Amended Standard Conditions and Charge Restriction Conditions (CRCs) of the Electricity Distribution Licence.

The purpose of these changes is to resolve the issues faced by DNOs with regards to recovery of the costs associated with the appointment of a Supplier of Last Resort (SoLR) in cases where an existing supplier goes out of business. The proposed modifications also seek to ensure Independent Distribution Network Operators (IDNOs) are treated on an equivalent basis to DNOs.

The draft modifications are provided in an Appendix published alongside this letter. We are consulting on changes to the following licence conditions:

- SLC 1. Definitions for the standard conditions
- SLC 38. Treatment of payment claims for last-resort supply
- CRC 2B. Calculation of Allowed Pass-Through Items

In addition, we propose the introduction of four new conditions:

- SLC 38A. Treatment of unresolved payment claims for last-resort supply where Valid Claim is received before 31 March 2019
- SLC 38B. Treatment of payment claims for last-resort supply where Valid Claim is received on or after 31 March 2019
- SLC 38C. Treatment of Valid Bad Debt Claims
- Amended Standard Condition BA5. Valid Bad Debt Claims

The issue – SoLR and the impact on electricity distribution companies

Electricity and gas is supplied through markets and on the basis of a competitive process in Great Britain. While competition has the potential to bring many benefits to consumers, a competitive process occasionally leads to companies failing. This applies as much in relation to the gas and electricity supply markets as it does to other markets.

When a supplier fails, our focus is to ensure continuity of supply for its customers and to avoid wider negative effects on the market. Such wider effects stem from the fact that, in practice, until the failed supplier's contracts have been transferred, or deemed contracts are established with a SoLR, there would be no practical way to prevent an existing customer from taking electricity or gas from the network. This will cause the network system operator to step in to perform a residual role of balancing the gas and electricity in the network. As the failed supplier will not be able to pay for the energy required to balance the networks in this way, these costs will fall to be mutualised across other industry participants. There is also the real risk that if a supplier fails without urgent intervention, consumer trust and confidence in the energy market would be materially damaged.

Ofgem can ensure continuity of supply to the failed supplier's customers and prevent these wider negative effects by appointing a SoLR to supply the failed supplier's customers at very short notice. This process also ensures that the credit balances of the failed supplier's residential customers are protected.

Certain costs are incurred as part of this process, some of which fall on the DNOs. These costs fall mainly into two categories:

- Claim from an Ofgem appointed SoLR for a Last Resort Supply Payment (LRSP); and
- Use of system (UoS) bad debts, i.e. the unpaid dues, to the DNOs, of one or more electricity suppliers that have had their electricity supply licence revoked

Last Resort Supply Payment

The DNOs have an obligation to compensate the appointed SoLR's approved LRSP claim. The DNOs recover the cost of compensating the appointed SoLR by changing their UoS charges accordingly. However, the DNOs are required to provide a 15-month notice of any changes to their UoS charges. Unless granted a derogation by the Authority, this can produce a time-delay between when the DNOs have to make good on their obligation to pay the appointed SoLR its approved LRSP claim and when the DNOs can then recover their costs through the new revised UoS charges.

Use of System Bad Debt

When a supplier fails (or has its supply licence revoked), it may have certain unsettled liabilities toward DNOs. Where such liabilities are due to the supplier not paying the relevant DNO for the use of their system to supply their customers premises, they constitute UoS Bad Debts. For a value to be considered as a Valid Bad Debt, it must be evidenced that all reasonable measures were in place and implemented to recover any such dues from the relevant supplier¹.

Summary of proposed changes

In order to resolve the issue as explained, we propose to make the following changes to the Electricity Distribution Licence.

¹ As per the "[Best practice guidelines for gas and electricity network operator credit cover](#)", Ofgem, 2005.

Amend SLC1. Definitions for the standard condition

We propose to amend SLC1 to include additional definitions. These are largely definitions that are moving to SLC1 as they are now apply to more than one condition.

For the avoidance of doubt, for the purposes of this informal consultation, we have only included new definitions or those which we propose to change. We have not included definitions that are not subject to change.

Amend SLC 38. Treatment of payment claims for last-resort supply

The current SLC38 outlines the basis on which all payment claims in relation to supply failure will be treated. This includes their obligations in relation to increasing UoS charges, the treatment of any shortfalls/excesses associated with the changes to UoS revenue and the obligation to publish statements explaining the changes in charges.

The proposed changes confirm that the condition will only apply to certain Valid Claims received before 31 March 2019.

New SLC 38A. Treatment of unresolved payment claims for last-resort supply where Valid Claim is received before 31 March 2019

The purpose of introducing the new condition is to:

- distinguish between claims and how they are treated based on when they were received and the stage they are at in the process of recovering the claims, specifically:
 - where claim is received before 31 March 2019 and the licensee has commenced the process of recovering the claim or already increased or decreased its UoS then it should follow the process in SLC38
 - when the claim has been received before 31 March 2019 but the licensee has not yet commenced the process of recovering the claim or adjusted its UoS then it should follow the new process outlined in SLC38A
- set out that any shortfall or excess should be dealt with via the pass-through term (PT_t) in CRC 2B.

New SLC 38B. Treatment of payment claims for last-resort supply where Valid Claim is received on or after 31 March 2019

The purpose of introducing the new condition is to:

- outline the treatment of claims received on or after 31 March 2019 or those received before 31 March 2019 but where the licensee has not yet commenced the process of recovering the claim
- outline the obligations on the licensee to pay the claimant and the timescales for those which may be determined in accordance with a schedule defined by the Authority, and in any event by no later than 15 months from the date of receipt of a Valid Claim
- outline that where there are cumulative claims in one year, these should be treated as a single aggregated figure for the purpose of calculating the total value; and
- set out the basis of a materiality threshold which, if breached by the aggregate value of claims, will allow the licensee to seek a derogation from the Authority to

increase its UoS changes to recover the value of the claims within the relevant regulatory year.

One of the consequences of these proposed changes would be that there could be multiple changes in charges within a charging year.

New SLC Condition 38C. Treatment of Valid Bad Debt Claims

The purpose of introducing the new condition is to:

- set out the basis on which the DNOs, on receipt of a Valid Bad Debt Claim, make payments to the claimant; and
- outlines that, where there are cumulative claims in one year, these should be treated as a single aggregated figure for the purpose of calculating the total value of bad debt claims.

New Amended Standard Condition BA5. Valid Bad Debt Claims

The purpose of introducing the new condition is to enable IDNOs to make a bad debt claim to each relevant distributor. The purpose of this change is to ensure IDNOs are treated on an equivalent basis to DNOs with respect to Bad Debt.

The condition does this by setting out:

- the process by which IDNOs can make claims in respect of bad debt incurred
- the details of what must be included in a bad debt claim to each DNO; and
- the basis on which the claim should be amended if the Revised Relevant Amount is found to be more or less than 10% of the Relevant Amount of the original claim.

Amend CRC 2B. Calculation of Allowed Pass-Through Items

The current CRC 2B sets out the basis on which each licensee calculates its allowed pass-through costs. We have included more than one version of this condition as the existing conditions are different for SSEH and for all WPD licensees.

The proposed changes, which will be the same for all licensees, will:

- introduce a new 'SLR_t' term which will be included in the calculation of pass-through costs as part of the Allowed Pass-Through Items (PT_t) term and allows for the pass-through of cost associated with Supplier of Last Resort Costs; and
- introduce a new 'EBD_t' term which will be included in the calculation of pass-through costs as part of the PT_t term and allows for the pass-through of Eligible Bad Debt.

Further considerations

Move from use of system charges to Other Charges²

The current distribution licence conditions allow for payment claims in relation to supply failure to be addressed through changes to UoS. We considered whether to change this to allow recovery through "other" charges. One argument for this approach is it could allow changes to charges to occur more quickly.

² Other Charges as defined within Section 2A of the [DCUSA](#) (v10.2; Para 19.2.1, pg 149)

On balance we have rejected this as it may still need a derogation to allow DNOs to deviate from their approved charging statement and therefore any time savings would be uncertain. Further, we consider the proposed approach is the most appropriate in terms of ensuring the equivalent treatment between DNOs and IDNOs.

Changes to system operator licence conditions

As part of this review we have also considered whether any changes are required to the transmission standard licence conditions, specifically: SLC C24: Energy Administration and Energy Supply Company Administration: National Electricity Transmission System Operator Shortfall Contribution Obligations. In particular, we considered whether this condition could be made broader in order to address future Supplier of Last Resort cases.

We are not proposing any changes to these conditions at this stage but welcome any views on the feasibility/merits of future changes in this area.

If any changes were proposed for the electricity system operator then we would also expect to consider whether similar changes were required to Special Condition 11D. Energy Administration: NTS Shortfall Contribution Obligations. This would be with the aim of ensuring consistency across gas and electricity.

Gas distribution licences

For the avoidance of doubt this consultation is only considering changes to electricity distribution licence conditions. However, where appropriate we want to ensure there is consistency between gas and electricity licenses in the treatment of SoLR costs. If any issues arise from this consultation that merits consideration for the gas distribution licences then we will consider and, if appropriate, consult on these separately.

Next Steps

Please provide your response to this consultation with your views on the proposed draft licence modifications, preferably by email, to: RIIO-ED1@ofgem.gov.uk. If replying by post, please send your response to:

Ofgem,
3rd Floor, Commonwealth House,
32 Albion Street
Glasgow
G1 1LH

Responses must be received by **5pm on 11th December 2018**.

If you have any questions regarding this letter, please contact Dinker Bhardwaj at dinker.bhardwaj@ofgem.gov.uk, in the first instance.