SP ENERGY NETWORKS

Network Planning & Regulation

Dinker Bhardwaj

By email to: RIIO-ED1@ofgem.gov.uk

Date
11th December 2018

Contact / Extension
Allan Hendry
0141 614 1971

Dear Dinker

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

SP Energy Networks (SPEN), represents the distribution licensees of SP Distribution plc and SP Manweb plc. We own and operate the electricity distribution networks in the Central Belt and South of Scotland (SP Distribution) which serves two million customers, and Merseyside and North Wales (SP Manweb) which serves one and a half million customers. We also own and maintain the electricity transmission network in the Central Belt and South of Scotland (SP Transmission).

We welcome the opportunity to respond to this Ofgem consultation, especially as it relates to a very live issue. When the licence was modified to require DNOs to process claims for Last Resort supply Payment, it was anticipated that this process would be rarely used. Unfortunately we now find ourselves in the position where there has been a large influx of suppliers to the market who cease trading as a result of financial distress to the extent that Ofgem has triggered the SOLR process many times in the last few months.

We hope that the number of SoLR instances will reduce going forward, if the conclusion of Ofgem's current Supplier Licensing Review consultation results in a greater level of scrutiny during the licence application process and an increase in ongoing monitoring to identify early those suppliers at risk of ceasing trading as a result of financial distress. However, we also believe that, the SoLR claim process itself needs to be reviewed and the ownership of this moved away from DNOs altogether.

It has been intimated that Ofgem will be publishing a further consultation to look at potential rules and restrictions in respect of credit balance, and we would urge that this consultation also reconsiders the role that DNOs currently play in the administration of last resort claims. Suppliers need to take on more responsibility for failures; at the moment, there is no deterrent to a supplier risk taking in its use of customer credit balances as the costs of failure are transferred to customers, via DNOs; this does not send the correct signals to deter risk-taking behaviour.

SP House, 320 St Vincent Street, Glasgow. G2 5AD

Telephone: 0141 614 0008

www.spenergynetworks.co.uk

We therefore believe that the proposed licence amendments should only be a temporary solution until DNOs are removed from this SoLR role altogether, or at the very least the DCUSA is modified to remove the mismatch between timing of last resort claim payments and recovery via UoS charges.

Notwithstanding our comments above, we have the following comments on the proposed Distribution Licence drafting:

Bad debt
Under the proposed CRC 2B drafting, Eligible Bad debt is passed through to Allowed Revenue **3** years after it was incurred (via the EBDA term). We believe that this is an unacceptable delay and inconsistent with the timescales for other pass through items, We believe that the timescale should be amended from 3 years to **2** years, and although this will mean that the value of the EBDA will be based on the licensee's view of Bad Debt that has incurred and not the value directed by the Authority, the definition could allow for any over/under allowance to be remedied the following year or via the K factor.

Payments to claimants and changes to UoS on receipt of a derogation
Within SLC 38B, paragraph 38B.9 outlines what the licensee must do after receiving a derogation under 38B.6. This includes increasing UoS charges and paying the last resort claimant '*in the Relevant Regulatory Year'*. We agree that it is a desirable policy intent to allow for the last resort payments and UoS income within the same regulatory year as this minimises a DNO's P&L exposure.

However, under the proposed drafting of the definition of 'Relevant Regulatory Year' a claimant might not get paid until 14 months after the DNO has received a claim and we question whether this is Ofgem's policy intent and whether suppliers who have submitted a claim that breaches the materiality threshold would accept this delay. Using real dates to illustrate the point, where a derogation has been received under 38B.6, if a claim was received on 1st April 2019 that breaches the materiality threshold this will have been received '*at least 60 days before the beginning of a Regulatory Year'*), and would result in increased UoS (under 38B.9b) and payments to the claimant (under 38B.9c) in the *Relevant Regulatory Year* 20/21.

If it is acceptable to Ofgem that some claimants may need to wait 14 months before they receive payment, then it is acceptable to DNOs as the proposed licence drafting allows last resort payments and UoS income to occur in the same year. However, if in reality DNOs receive pressure to pay the DNOs before this (ie within a charging year), then the licence drafting should be amended to allow DNOs to also amend UoS from the point that the payments need to start.

Materiality threshold
As stated above, we see no justification in DNOs being exposed to *any* cash flow risk as a result of supplier failures. Without prejudice to this view, and until this can be addressed, we strongly support the concept of the materiality threshold and have the following comments on the drafting in this area.

We do not believe the drafting of 38B.5 and the definition of 'Excess Specified Amount' reflects the policy intention in this area. We understand from the DNO Working Group,

that the policy intent is for a claim that breaches the materiality threshold to be managed in full via an increase in UoS in the relevant regulatory year. For example, if a DNO's materiality threshold is £2m, and the aggregate value of claims it has received in a given year is £1.5m, then if a claim for £1m is received the DNO should be able to recover the entire £1m via an expedited increase in UoS charges under SLC38B.9 instead of via the SLRA term in Part H of CRC2B.

The drafting in 38B.5 relates to recovery of 'Excess Specified Amount' and this is defined as 'the aggregate value of claims in excess of the materiality threshold', which using the above example suggests that a DNO could only increase UoS for the £0.5m above the materiality threshold

As this is a key definition, we would suggest that Ofgem works with DNOs to draft a suitable alternative definition to ensure it meets the full policy intent. As a starting point our suggestion would be:
38B.5 If the value of aggregated payments to be made by a licensee in respect of Valid Claims in any Regulatory Year would exceed the materiality threshold amount applicable to the licensee, as shown in Appendix 1 (the "Materiality Threshold"), the licensee may within 28 days of receipt of the Valid Claim that results in breach of the Materiality Threshold give notice to the Authority of its intention to increase its Use of System Charges for the Relevant Regulatory Year to the extent of: (i) the Valid Claim that results in breach of the Materiality Threshold; and (ii) any subsequent Valid Claims made within the Relevant Regulatory Year.~~that the licensee reasonably estimates is necessary in order to recover the Excess Specified Amount.~~
OR if 'Excess Specified Amount' continues to be used elsewhere in the condition, *k*eep 38B.5 as is and change the definition of Excess Specified Amount to
'*Excess Specified Amount means the value of (i) the Valid Claim that results in breach of the Materiality Threshold; and (ii) any subsequent Valid Claims made within the Relevant Regulatory Year*

3 months – 60 days
The drafting in 38B.3 'Obligation to pay the Claimant', states that the licensee must make payments to the Claimant, by monthly instalments commencing 60 days after the date on which the Valid Claim was received. The DNO Working Group requested for this to be 3 months to mitigate recovering costs four years later. For example, the 60 days would mean that a claim was received on 1 January 2019, costs would be incurred by the DNO in 2018/19 i.e. the January to March 2019 period, therefore some revenue would be recoverable in 2020/21. As a result of the 15 month requirement in the DCUSA, DNOs will have already published 2020/21 Use of System charges in December 2018 and these would have been calculated without value of the payments made in Jan-Mar 2019. This would in isolation create an under-recovery in 2020/21, which would not be able to be recovered until the K factor is adjusted in 2022/23, creating a four year lag as opposed to a two year lag.

This creates an additional issue for DCUSA change proposal DCP 332 (Appropriate treatment & allocation of Last Resort Supply Payment claim costs) whereby the element of charges to recover the specific SoLR allowances need to be isolated, via the pass-through term and not the correction factor.

We would therefore like to request that the 60 days is changed to 3 months as this would mean a claim received on 1 January 2019 would not be paid until 1 April 2019, and as

such we would recover this from 2021/22 relating to costs incurred from 2019/20, hence a two year lag rather than a four year one.

Energy Supply Company Administration Order:
We do not believe that condition 38B.2 serves any purpose in reality except for closing the option of invoking this licence condition in the event that Ofgem do decide to appoint a Supplier of Last Resort. It says that if a Special Administration Regime (SAR) is triggered, then this licence condition will not apply, but if SAR is triggered then there would not be a valid claim anyway as there would be no SoLR appointed.

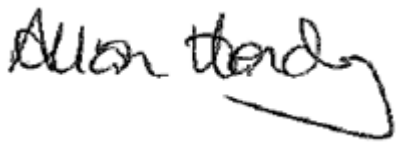
We believe this may have originated as DNOs within the Working Group were looking for some assurance and protection of significant exposure from receiving a claim in relation to one of the big 6 suppliers. The drafting does not provides such protection, as there is nothing to prevent Ofgem from appointing a SoLR for a big 6 supplier. We need clarity on what will happen if one of the big 6 suppliers ceases trading as a result of financial distress We would urge Ofgem to use its Supplier Licensing Review consultation to consider alternative ways to protect DNOs from exposure to a last resort claim from one of the big suppliers in the market.

Worked examples
We believe that the drafting would benefit from a table of worked examples. The changes will impact multiple resources across our DNO business and worked examples would help ensure that the licence changes are applied consistently by us and other DNOs. Such a table should be populated for examples of claims received at various times in a year which do and do not breach the materiality threshold and we have provided suggested table headings below.

Claim received by DNO	Latest commencement date of payments to the claimant	Term impacted in SLR calculation	year 't' in relation to SLRt	Earliest date in which UoS changes will go live

If you would like to discuss any aspect of this response further, then please do not hesitate to contact me.

Yours sincerely,



Allan Hendry
Head of Licence & Revenue
SP Energy Networks