Making a positive difference
for energy consumers

Gas and Electricity Suppliers,
Electricity Distribution Network
Operators, Gas Transporters and
all other interested parties

Email: supplier@ofgem.gov.uk
Date: 17th December 2021

Dear colleague,

Last Resort Supply Payment Claim from Scottish Power Energy Retail Limited

On 19 November 2021, we[1] published our minded-to position on Scottish Power Energy Retail Limited's ("Scottish Power") claims for a Last Resort Supply Payment ("LRSP") for additional costs incurred in acting as a Supplier of Last Resort ("SoLR")[2] to the former customers of Daisy Energy Supply Ltd (which traded under the name "Yorkshire Energy") and Tonik Energy Ltd ("Tonik Energy").

This letter confirms our decision to consent to Scottish Power claiming a LRSP of up to £2.4m[3] for Yorkshire Energy and £1.04m[4] for Tonik Energy. Our decision will allow Scottish Power to recover the costs of protecting the credit balances owed to former customers of Yorkshire Energy and Tonik Energy in line with commitments given at the time of the SoLR appointments, and certain other costs incurred in complying with the terms of the Last Resort Supply Direction ("LRSD")[5].

In taking this decision, we have given due regard to Ofgem's principal objective of

[1] References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day-to-day work. This decision is made by or on behalf of GEMA.
[2] Consultation on Last Resort Supply Payment Claim from Scottish Power for Yorkshire Energy and Consultation on Last Resort Supply Payment Claim from Scottish Power for Tonik Energy
[3] £2,407,071.98
[4] £1,035,129.43
[5] Direction to appoint Scottish Power Limited as Electricity Supplier of Last Resort for Yorkshire Energy , Direction to appoint Scottish Power Limited as Gas Supplier of Last Resort for Yorkshire Energy , Direction to appoint Scottish Power Limited as Electricity Supplier of Last Resort for Tonik Energy and Direction to appoint Scottish Power Limited as Gas Supplier of Last Resort for Tonik Energy

protecting the interests of current and future energy consumers, the relevant provisions of Scottish Power's gas and electricity supply licences, Ofgem's "Guidance on supplier of last resort and energy supply company administration orders" (our "Guidance")[6], the terms of the LRSD and the particular circumstances of compliance with the LRSD.

Background

The SoLR Process

Electricity and gas supply is a competitive activity in Great Britain. While competition has the potential to bring many benefits to consumers, in a competitive market, companies that are not operating efficiently may fail. This applies as much in relation to the gas and electricity supply markets as it does to other markets.

It is Ofgem's statutory duty to protect customers' interests in light of supplier failure. When a supplier fails, our focus is to ensure continuity of supply for its customers and to minimise wider negative impacts on the market. These wider effects stem from the fact that if an energy supplier fails, its customers will continue to be physically supplied with gas and/or electricity, but the supplier will not be able to meet the costs of providing this energy. In these circumstances, the costs of procuring the necessary electricity will be smeared across all suppliers and the costs of procuring gas will fall to the relevant shipper. 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 minimise these wider negative effects by appointing a SoLR to supply the failed supplier's customers at very short notice[7].

Claim for Last Resort Supply Payment

As set out in the gas and electricity supply standard licence conditions, a supplier may make a claim for any additional costs they incur in complying with a LRSD.

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[6] Supplier of Last Resort: Revised Guidance 2016

[7] The obligation for a supplier to comply with a LRSD derives from standard licence condition 8 of each supplier's gas and electricity supply licences and is intended to ensure a universal service for Great British energy consumers (for further information on this universal service, see Articles 3(3) of the EU Directives 2009/72/EC and 2009/73/EC). The duties of a SoLR are further described in our Guidance and the LRSD contains specific details of Scottish Power's obligations to supply Yorkshire Energy and Tonik Energy's former customers.

As part of their competitive bid to become a SoLR, a supplier will include whether they expect to make a claim for a LRSP, or whether they wish to waive this right. As stated in our guidance[8], our preference is for the SoLR not to make any claim, and we expect efficient SoLRs to be able to minimise their exposure to otherwise unrecoverable costs to reduce the costs smeared across the rest of the market.

In our guidance, we explain that we will decide on a case-by-case basis whether it might be appropriate for a SoLR to make a claim under these arrangements. We also explain that we would consider whether the amount of any claim or the reasons for any claim were reasonable. In that guidance, we note that, in certain circumstances, we may consider it appropriate to approve a claim where it relates to costs associated with the protection of customers who held a credit balance with the failed supplier.

The LRSP Process

Once appointed, a SoLR may make a claim for a LRSP from relevant distribution networks where we have given our consent to the amount claimed. On 29 October 2021 Scottish Power notified us of its intention to claim for a LRSP, and on 19 November 2021 we proposed to allow Scottish Power to make a LRSP claim consisting of £2.4m[9] for Yorkshire Energy and £1.04m[10] for Tonik Energy, consisting of the following elements:

Table 1: Scottish Power SoLR LRSP Claim for Yorkshire Energy

Item	**Cost**	**Cost Claimed (£)**	**Decision (£)**
1	Domestic credit balances (active and closed) above £5.8m	2,269,390.00	2,174,080.01
2	Working capital	250,433.00	232,991.97
	Total	**2,519,823**	**2,407,071.98**

[8] Supplier of Last Resort: Revised Guidance 2016
[9] Consultation on Last Resort Supply Payment claim from Scottish Power
[10] Consultation on Last Resort Supply Payment claim from Scottish Power

Table 2: Scottish Power SoLR LRSP Claim for Tonik Energy

Item	Cost	Cost Claimed (£)	Decision (£)
1	Domestic credit balances (active and closed) above £14.6m	958,908.07	958,908.07
2	Working capital	79,183.59	76,221.36
	Total	**1,038,091.66**	**1,035,129.43**

Our decision

We are satisfied that the claim represents no more than the total cost incurred by Scottish Power in complying with the LRSD. On balance, given all specific circumstances of this case and taking into consideration all information available to us, our decision is to consent to Scottish Power recovering a LRSP of up to £2.4m[11] for Yorkshire Energy and £1.04m[12] for Tonik Energy.

For the avoidance of any doubt, we consider on a case-by-case basis whether it may be appropriate for any SoLR to make a LRSP claim. We have set out below the reasons for our decision in this case. This should not be taken as setting a precedent for any future claims, which would also be considered on their merits and on a case-by-case basis, taking into account all relevant circumstances of the particular case.

On 19 November 2021 we published two letters setting out our proposed position on the Scottish Power LRSP claim for Yorkshire Energy and Tonik Energy. We received four responses to our letters from domestic and non-domestic suppliers, and gas and electricity network operators. Of these:

- One respondent queried the working capital element of the claim.
- One respondent queried our proposal to omit costs associated with the Yorkshire Energy loyalty scheme from the claim.

[11] £2,407,071.98
[12] £1,035,129.43

- Two requested further clarity on whether this claim would breach the LRSP materiality threshold[13] in SLC 38B for claims being paid and recovered by electricity distribution network operators.

Having considered all the responses and queries raised, our continued view is to approve Scottish Power's LRSP claim for Yorkshire Energy and Tonik Energy as set out above. Our responses to issued raised during consultation are addressed below.

Reasons for our decision

Cost item: Credit balances

Scottish Power has requested our consent to recover £2.2m[14] for the cost of refunding credit balances to former customers of Yorkshire Energy and £959k[15] for former customers of Tonik Energy, above the amounts they agreed to absorb from their own revenues on their appointment as SoLR. Our published guidance sets out that we may in certain circumstances consider it appropriate to approve a claim associated with costs incurred in repaying credit balances to customers who had a positive credit balance with a failed supplier. We are satisfied in this case that (subject to the points discussed below) the claimed amount is consistent with the relevant criteria and in particular, is consistent with Scottish Power's commitment at the time of its appointment as SoLR to absorb a portion of the credit balances for customers Yorkshire Energy and Tonik Energy.

Credit balance costs for former customers of Yorkshire Energy and Tonik Energy are additional to the costs that Scottish Power would otherwise face as a supplier. We have considered whether the costs Scottish Power is seeking to claim for credit balances are otherwise unrecoverable; it may still be the case that Scottish Power is able to recover some of this claimed amount through the ongoing administration process for each of the failed suppliers. Scottish Power has, in accordance with the requirements of the LRSP process, submitted a subrogated creditor claim for the costs incurred in repaying credit balances. Given this, our decision is to consent to this element of the claim, subject to the outcome of the Yorkshire Energy and Tonik Energy liquidation processes. At this

[13] SLC38B includes a materiality threshold for levy claims. Claims below this materiality threshold (either individually or in combination with other claims) are paid out by networks 3 months after they receive a valid claim. Where a claim (or series of claims once the materiality threshold has been exceeded) is above the materiality threshold, provided DNOs give notice within 28 days of receiving a valid claim and we grant them any necessary derogation, they will be able to raise their charges from the following April providing the claim is approved prior to the 31 December.
[14] £2,174,080.0
[15] £958,908.07

point, the final amount Scottish Power can claim for credit balances would be adjusted to reflect any costs recovered through the liquidation process.

One respondent queried our minded-to position to omit costs associated with the Yorkshire Energy loyalty scheme from the Scottish Power LRSP claim. Promotions such as loyalty schemes can result in credit being added to accounts at the discretion of the supplier. Given the discretionary nature of these payments we consider these are different to payments made by customers for the delivery of energy which result in a credit balance on their account and which are explicitly referred to in SLC9 of the Supply Licence. Therefore, we do not consider that these loyalty payments should necessarily be covered by a LRSP as we continue to believe that our safety net exists to protect money that customers have paid into their account (if it is in credit). A SoLR may choose to honour this promotional credit to the direct benefit of the customers they have acquired, but this is a commercial decision for the relevant SoLR to make[16].

We accept however, that in cases where, for example, loyalty scheme payments are indistinguishable from credit balances resulting from payments made by customers, we may consider it appropriate to cover these via the LRSP as there would be no practical way to separate them. However, in this case, Scottish Power and the Administrator were able to distinguish these payments from customer credit balances. Therefore, for the reasons given, we do not consider it would be appropriate to cover these via the LRSP.

As stated above, we consider that this position is in line with the definition of 'Credit' in SLC 9 of the Supply Licence[17]. SLC 9 defines 'Credit' by reference to the amount of payments made by a Customer to the supplier under a Domestic Supply Contract.

Cost item: Working capital

Scottish Power's claim includes £233k[18] for Yorkshire Energy and £76k[19] for Tonik Energy for the cost of interest on working capital to finance the additional costs incurred as a result of acting as the SoLR. Having considered all the evidence available to us, our decision is to consent to Scottish Power recovering the cost of making capital available to fund the SoLR process. A minor adjustment was made to the Tonik Energy working capital claim to account for when Scottish Power will begin recovering costs. This has

[16] In our Decision to modify SoLR supply licence conditions in November 2018, we set out our view that 'goodwill payments' should not fall within the definition of credit under SLC9.
[17] Standard conditions of electricity supply licence and Standard conditions of gas supply licence
[18] £232,991.97
[19] £76,221.36

resulted in a minor reduction in the working capital element of the claim as outlined in Table 2.

One respondent queried the working capital element of the LRSP claim, citing the difference in working capital claims in proportion to domestic credit balance claim for Tonik Energy and Yorkshire Energy respectively. To clarify, this difference in relative size of working capital claim is due to differences in the timing of when Scottish Power incurred the domestic credit balance costs. Specifically, former Yorkshire Energy customers' balances transferred over earlier than Tonik's, meaning the lag between Scottish Power incurring the cost and recovering this via the LRSP is longer and therefore, the costs are proportionately higher.

Recovery of LRSP claim

Two respondents requested clarity as to whether Scottish Power's claim is in excess of the electricity network operator's Materiality Threshold. The electricity distribution licence sets out that electricity network operators must commence payments for a LRSP claim within three months of receiving a valid claim, unless the Materiality Threshold is reached. To clarify, the £24.5m materiality allowance has not been exceeded for this regulatory year. Therefore, in line with SLC 38B, Scottish Power's claims for £2.4m[20] and £1.04m[21] will be added to the claims that have not exceeded the Materiality Threshold, meaning the electricity distribution network operators will start repaying claims from three months after receiving the valid claim and recover costs two years after costs were incurred.

Scottish Power will be paid the amounts specified in the gas and electricity consents published alongside this decision, by the relevant licenced gas and electricity network companies. This will be recovered by the relevant gas and electricity distribution networks allocated in proportion to the total number of nationwide gas and electricity supply points. We consider this apportionment to best enable broad socialisation of the claim costs in line with the intent of the SoLR regime to protect all consumers in the market, for example, through limiting the extent of unpaid industry bills of a failing supplier. As per the standard conditions of the gas and electricity supply licence regarding LRSP claims, Scottish Power will be able to submit a claim to each relevant distribution network operator, based on the amount we have consented to and each

[20] £2,407,071.98
[21] £1,035,129.43

network's share of the total premises served by the relevant networks, in each fuel respectively. We expect Scottish Power to do this on the basis of the customer numbers contained within the network companies' regulatory reporting packs. This has the advantage of being a data source that is transparent and consistent as between gas and electricity.

Yours faithfully,

Lesley Nugent
Deputy Director, Retail Directorate