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5th April 2024

Dear Mr Hall,

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Ty Wales & West
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Wales & West Utilities (WWU) response to Supplier of Last Resort (SoLR) Levy Offset Policy Consultation

Thank you for the opportunity to respond to this consultation. WWU is a gas transporter serving 2.5 million supply points in Wales and south-west England. This response is not confidential and may be published by Ofgem.

We address each of the consultation questions in turn below and in summary, our position is that we support, in principle, the aim of the SoLR Levy Offset; however, we do not support the policy proposal for the SoLR Levy Offset for the reasons set out below:

- Ofgem has not provided a comprehensive impact assessment demonstrating that the potential benefit to consumers would exceed the cost of implementation;
- we do not think that the scheme considers the different arrangements between gas and electricity markets; in particular that Shippers will generally hold gas hedges, whereas in electricity it is the Supplier that holds the hedge;¹
- it is not apparent that Ofgem has considered the option of making modest changes to Supplier licence conditions that survive termination. This would enable the Supplier to make the claim and not involve the networks, a seemingly low risk and cost approach that achieves the policy objective more easily;

This letter, together with the response from the ENA response to this consultation, forms the basis of WWU's response to the SoLR Levy Offset policy consultation.

¹ This point was raised in the ENA response dated 14th December 2023 to the previous consultation

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Q1. Do you agree with our problem statement?

We understand and support the policy intent of the SoLR Levy Offset proposal; however, we disagree that networks are best placed to act in a subordinated creditor capacity to implement these arrangements. It is unclear how Ofgem could compel networks to enter into arrangements exogenous to their own licence conditions and the proposal further blurs the lines of networks role in supplier “failure”. Furthermore, given this proposal seeks to complement Ofgem’s wider package of policies to strengthen financial resilience of Suppliers, then the natural starting point for arrangements should be Suppliers and implementation should be through the supplier licence.

We accept that in some cases there is a risk that electricity Suppliers may have hedges that when unwound result in shareholders receiving a distribution that could have been used to offset a claim by a SoLR. We agree that in these cases the benefit from unwinding these hedges should be returned to customers. We are disappointed that the different arrangements in gas, in that these hedges are held by Shippers, has not been acknowledged and taken into account in the design of the process. Furthermore, the wider work on financial resilience for Suppliers has not been applied to Shippers. We raised these points in our response to the consultation issued in June 2022.

We note that the risk is described in general terms and there is not a specific example of the risk materialising.

Q2. What are your overall views on whether the proposal would deliver on the aims of the SoLR levy Offset?

As hedges are held by Shippers and not Suppliers in the gas industry, this seems unlikely to deliver any value to gas consumers. As described in our answer to question 3, we believe that there is an alternative option that would simplify the process by enabling the SoLR to make the claim and we urge Ofgem to seriously consider our proposal.

Absent any comprehensive impact assessment by Ofgem in respect of the potential surpluses distributable to shareholders from historic supplier failures, it is not possible to understand the net consumer benefit, if any, from the proposals. Furthermore, the inability to apply the proposals retrospectively (for already failed suppliers) necessitates any impact assessment to be normalised for the unprecedented supplier failures in 2021 and 2022. The evaluation should duly regard the additional resource requirements for networks to administer the proposals and additional advisory fees that will be incurred for insolvency expertise which networks, unlike suppliers, do not already possess.

Q3. What are your views on the proposed option of network companies being creditor, as opposed to other alternatives.

We consider that the SoLR should be the unsecured creditor in the offset levy proposals and claim directly from the failed Supplier, this would avoid duplication of having each network making claims for essentially the same debt against the same Supplier. Ofgem's position seems to be based on the view that:

- 1) the relationship between the failed Supplier and the unsecured creditor needs to be created by deed; and
- 2) that it is easier for Suppliers to sign deeds in favour of networks than for each Supplier to sign deeds in favour of each of the other Suppliers.

It appears, from the consultation document, paragraph 4.3, that Ofgem considers a deed is required because the licence alone is insufficient to create the relationship necessary to implement the SoLR Levy Offset:

“Upon revocation the failed supplier is no longer bound by the conditions of the licence. Therefore, the obligation to pay SoLR Levy costs cannot be in the licence alone.”

The option of putting the obligations in the Supplier licence, rather than a separate deed, with a carve out that this obligation survived beyond termination of the licence would overcome the above perceived obstacle. As the licence is legally a contract this should be achievable as many contracts have obligations that survive termination. The licence would also have to enable the SoLR to enforce this obligation as a third party, but this can also be achieved with suitable drafting. This option is not considered by Ofgem in the consultation document and therefore it is not clear whether this option has been considered and discounted or not considered at all.

If this option was adopted the process would be as follows:

- 1) SoLR makes initial claim; Ofgem approves, networks recover value through network charges and passes to SoLR;
- 2) SoLR makes claim against failed Supplier;
- 3) insolvency process concludes;
- 4) SoLR makes final claim; Ofgem approves, network recovers value and passes to SoLR;
- 5) or, if the SoLR receives payment through insolvency process, it pays the network and the network refunds through its charges.

This would be a more efficient process as it would avoid each network having to process its share of the claim. It is also a lower risk option, as there is no need for separate deeds with networks that need to be monitored, and rights and obligations are enshrined in supplier licences. It would also keep retail issues in the retail sector which is clearly the sector with the best knowledge of likelihood of recovery and the skills and experience to achieve this. A

further advantage of a SoLR centric approach is that the SoLR can decide whether to submit a claim to the party administering the insolvency of the failed Supplier. If the SoLR considers that the cost of pursuing a claim is likely to be more than the value realised then they can decide not to submit a claim. Ofgem can then make an assessment of that decision when it considers the SoLR's final claim. Our understanding of Ofgem's preferred position is that the networks would be obliged to make a claim and would have no discretion in the matter; even if they had discretion, networks are much less well placed than a SoLR to assess the likelihood of recovery because they do not operate in the trading market and are prevented from doing so by their licence. As noted in the consultation SoLRs can already claim the value of customer credit balances from the failed supplier as an unsecured creditor so this would be an additional element for them to make under the same claim and administer rather than a new process as is proposed for networks.

If Ofgem rejects our preferred approach then we request that it sets out whether this is for reasons of principle, process or cost, together with its reasoning.

As regards the cost to networks of implementing Ofgem's preferred option, we note paragraph 3.15 in the consultation states:

"In most cases, we do not think the process for making a claim in the insolvency process would result in material costs for the network companies. Where costs may be material, we would look to ensure the network companies can recover the efficient costs of taking on this role. We welcome views from network companies on the likely materiality of any costs and potential recovery mechanisms."

The size of the costs likely to be incurred by networks is unclear; however, based on our experience with the liquidation of a Shipper in 2021 it seems likely that there will be a fair amount of work should we need to pursue a claim and we would incur external specialist insolvency advisory fees due to the lack of in-house expertise.

We welcome that networks would be able to recover the efficient costs of taking on this role, should they be obliged to do so. **All** efficiently incurred costs should be pass-through as this is not an activity that is part of our transportation business activity and so there should be no materiality cap. For the avoidance of doubt, networks should be allowed to claim all costs incurred regardless of whether any value is recovered from the insolvency process. The most appropriate way of enabling networks to recover the costs is to allow pass-through of these costs under Special Condition 6 of the Gas Transporters Licence. In line with other Miscellaneous Pass-through costs (MPt) such amounts will need to be directed by Ofgem.

Q4. What are your views on the creditors ranking in the insolvency waterfall as unsecured creditors and do you think another classification would be more appropriate?

We are not experts in insolvency but understand the debt would be classified as an unsecured creditor and that priority of claims, in terms of recovery of surplus assets, is governed by insolvency law and will not change unless there is a change in primary legislation. Our concern is that as creditors have to prove the debt owed, that we would be unable to do this until Ofgem had approved the SoLR's final claim and this relies on the proposed deed being in place. Should the insolvency process, which will run entirely separately from the Ofgem process with the SoLR, complete before we have a provable final amount, then we may not be able to recover anything from the insolvency process. Were the SoLR to make the claim direct then the process is much simpler and the SoLR will be directly in contact with the administrator and so will know the progress of the insolvency process first hand. In addition, Suppliers will have more experience of pursuing claims than Transporters who are much more familiar with the credit arrangements in the Uniform Network Code.

Q5. What are your views on the creditor claim being contingent on a valid claim being made by a SoLR for a LRSP? Do you think that the creditor claim could be formulated or calculated in another way?

Under Ofgem's preferred process a SoLR making Last Resort Supplier Payment (LRSP) claim to a network is necessary before a network can make an unsecured creditor claim. If Ofgem moved to the SoLR making the creditor claim, then the two claims could be independent of each other. If the SoLR believed that the cost of making the creditor claim outweighed the value likely to be received then it may not make a creditor claim but it may make a SoLR claim; on the other hand, if it thought that it was highly likely to recover its costs using a creditor claim, it might decide that it did not want to make a SoLR claim, perhaps to avoid putting costs temporarily onto other consumers, or because it thought that the LRSP process might take too long.

Q6. What are your views on the deed as it is currently drafted?

As described in our response to question 3, it is our view that Ofgem should reconsider its position that a deed between each Supplier and each network is the only viable option and instead consider the option of putting obligations in the supplier licence as we propose in our response to question 2. As we consider that the deed is not needed, we have not provided any comments on the drafting.

Q7. What are your views on the proposed license changes for suppliers and networks? Please identify any factors relating to the drafting of license changes that we should consider at this stage.

The consultation does not make any detailed proposals for licence changes; however, our view is that a full review of Standard Special Condition A48 would be required to ensure that among other things:

- 1) it properly recognises the multi-stage claim process;
- 2) the multi-stage process removes the additional burden imposed on GDNs of claims being allowed up to 31st December, this requires full resubmission of the Price Control Financial Model with full governance early in January, we accepted this temporary measure to assist the industry on the understanding that it was temporary;
- 3) it clearly recognises the creditor claim process and what happens if that closes before the final Last Resort Supplier Payment claim is received and is proved to the insolvency practitioner.

In addition, Special Condition 6 would need to be amended to all pass-through of efficiently incurred network costs in relation to the creditor claim.

We would also want to ensure that the arrangements in Gas Transporter Licence Standard Special Condition A48 works properly with Supplier Condition 9.

If Ofgem adopted our proposal, then the Supplier licence would need to be amended to include the obligations to the SoLR that would endure after termination of the licence and to give the SoLR third party rights to enforce the obligations.

We are concerned with the implication of paragraphs 4.4 and 4.5 that imply that Ofgem will only make the absolutely necessary changes to Supplier licences leaving drafting to properly implement the multi-stage claim process to a later date. The licence changes should cover all the changes required to make the process clear in all licences, if it is indeed a prerequisite that introducing the multi-stage claim process permanently is necessary to implement the SoLR Levy Offset policy.

Q8. Have we identified the key impacts, risks and benefits of the SoLR Levy Offset, and are there any impacts we should give further consideration to? Do you think that overall this would be of benefit to consumers?

No, Ofgem needs to consider our proposal of putting the obligations on Suppliers into the licence in favour of the SoLR rather than in a deed with the networks. This would require these provisions to survive termination and to allow the SoLR to enforce the obligations as a third party. We consider this to be the lowest risk and cost option to implement the SoLR Levy Offset. Please see our response to question 2 for more details.

Our understanding is that the hedges, where most of the value is anticipated to reside, are generally held by gas Shippers not gas Suppliers and therefore, we anticipate very little if any value be recoverable from this process in gas.

The consultation states at paragraph 5.1:

“Based on information available from insolvency office holders' reports, we anticipate that unsecured creditors have, or will, receive a distribution in the majority of insolvency processes relating to suppliers that failed since Autumn 2021.”

However, this statement does not state what proportion of each claim is likely to be recovered; so it is unclear what the actual distribution will be and hence whether overall the scheme would have benefited customers. Furthermore, the process will only apply to failures after its implementation and with Ofgem's tightening of regulation of suppliers we may expect failures to return to the low levels we saw before the 2021 and 2022 failures.

Misleading statement in consultation

Paragraph 2.5 of consultation states:

“The costs are initially paid by the electricity and gas distribution networks (also referred to in this document as ‘the networks’) once Ofgem has consented to the claim. Through network charges, these costs are ultimately paid for by domestic energy consumers in Great Britain.”

This suggests that networks pay the SoLR the value of the claim and then collect the value of the claim through network charges. This is incorrect, the networks receive the claim, set charges to recover it in line with the provisions in SSC A48 and then make monthly payments to Suppliers once the income has been received.

Yours sincerely,



Richard Pomroy

Regulation Manager

Wales & West Utilities