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Dear David,

Response to Consultation on SoLR Levy Offset

1. SSEN Distribution welcomes the opportunity to respond to Ofgem's consultation on the proposed Supplier of Last Resort (SoLR) Levy Offset arrangements. In addition to this individual response, we fully support the ENA (Energy Networks Association) response collectively on behalf of electricity and gas distribution network companies.
2. We support the principal behind this consultation – i.e. that if money can be recovered from failed suppliers as part of their insolvency proceedings, consumers should see a return of recovered value rather than the shareholders of the failed supplier, having paid out for its failure via approved LRSP (Last Resort Supply Payment) claims made by the appointed SoLR. These claims are recovered from consumers via DUoS (Distribution Use of System) charges issued from DNOs to their supplier, noting this element of the charge is unrelated to the cost of the distribution network.
3. It is important to prioritise an efficient solution for the return of any residual value to consumers in order to maximise the net value returned after costs. We do not agree with Ofgem's proposal that the best way to facilitate this is for DNOs (and gas distribution networks) to act as an 'unsecured creditor' to suppliers, triggered in the event of their failure. We believe there are more efficient supplier-based solutions that are more likely to deliver value back to consumers and which merit further consideration.
4. As a matter of principle, and in line with the principles of good regulation, we do not agree that it would be appropriate for DNOs to be obligated as a condition of their licences to enter a deed with suppliers for costs that are unrelated to the distribution network services that DNOs provide. If obligations are to be placed on DNOs, they must be fully detailed in the licence condition. A requirement through a licence condition to enter into an unspecified agreement would be highly unusual. It is also highly questionable that the Authority has the legal power to allow it to impose such licence conditions. If this proposal is taken further, the Authority would need to demonstrate it has the vires create such a licence condition, properly follow the statutory consultation process, and demonstrate that taking such action was compatible with the Authority's wider legal duties, its Strategy and Policy Statement, and its adopted standards of good regulation.

5. We have a range of concerns with the proposed measures relating to potential legal and commercial issues, the overall efficiency of the proposals, and their appropriateness given these costs are wholly unrelated to the distribution network services that DNOs provide for our customers. These proposals would, in effect, artificially insert DNOs into failed suppliers' insolvency proceedings as an 'unsecured creditor' in order that DNOs act as a debt recovery agent for consumers for energy retail costs. We emphasise that these costs are not related to the distribution network, and we would not otherwise have this commercial relationship with the failed supplier.
6. This proposal would place additional administrative cost burden and financial risks on distribution networks. It remains unclear how our agreement to this would serve the interests of our customers and stakeholders. An alternative streamlined solution could be readily introduced via supplier licencing arrangements and/or the SoLR appointment process that would avoid muddling energy retail and electricity distribution issues, responsibilities, and balance sheets. As proposed, this increases the risk of wider financial contagion throughout the sector in the event of a supplier failure. We believe that a simpler, more efficient option would be for the appointed SoLR to seek to recover any residual value for consumers in the first instance.
7. It remains unclear what powers and/or duties the Authority would apply to introduce the proposed deed via the distribution licence. This is fundamental to the introduction of these arrangements and must be clarified. It is important that any new obligations imposed on DNOs are properly detailed in the licence based on appropriate application of the Authority's powers and due statutory consultation process. There are numerous practical considerations that are not properly addressed in the consultation relating to crucial details of impact of the proposed deed. These include the financial accounting treatment of these costs, confirmation from insolvency experts that the Authority's consent to SoLR levy costs could be used as 'proof of debt' in insolvency proceedings, and that funding arrangements for additional costs to DNOs will be appropriately provisioned for. These require substantially more detailed exploration and justification than is offered. At present, there is insufficient detail for us to be able to comment meaningfully on the proposed wording of the deed without clarity on the legal, practical, and financial impacts. We are therefore unable to support it as currently proposed given the limited information that has been provided.
8. We encourage Ofgem to reconsider this issue from first principles in terms of how best to serve the interests of consumers. This should involve putting responsibilities where they can be efficiently discharged and where the potential for successful net value recovery can be maximised via a simple, transparent process (i.e. keeping retail issues within the retail market segment). The consultation presently offers no evidence of the potential sums that could be recovered by a DNO acting as an 'unsecured creditor' versus the administrative costs that would be incurred via participation in insolvency proceedings. It also does not consider the potential for additional financing costs that could be incurred subject to the accounting treatment of debts owed to DNOs as an 'unsecured creditor'. It offers no information on how the related costs to DNOs would be remunerated. Clarity on these points is pre-requisite to our ability to offer an informed response prior to the potential imposition of additional duties, that may otherwise come at a cost to our customers. This proposal must be demonstrated to offer value for consumers based on evidence and potential for material net value recovery, and any new obligations placed on DNOs to facilitate this would have to be appropriately funded. Furthermore, this change would likely impact numerous aspects of our financial reporting to Ofgem such as the Price Control Financial Model and Regulatory Finance Performance Reporting, that would have to be amended accordingly.
9. We believe that suppliers are best placed to carry out the proposed debt recovery role – as envisaged when the current market structure was established and enshrined in current legislation. This is well-aligned to

existing supplier functions and expertise given their experience in credit management matters, alongside their first-hand knowledge of operating an energy supply business. This would be a natural fit for the SoLR as a condition of their appointment given the relationship they will need to have with the failed supplier as part of the customer transfer process, the high likelihood that they will be claiming for other costs (such as customer credit balances), and the debt recovery expertise that suppliers already have within their organisations.

10. A retail sector solution as a matter of supplier-to-supplier relationships would substantially simplify the proposals, offering an efficient solution that avoids blurring responsibilities between energy retail and electricity distribution market segments that were historically unbundled involving clear separation of activities and balance sheets. Proposals that involve DNOs taking on additional responsibilities and costs relating to energy retail matters risks introducing unnecessary complexity, potential for confused financial accountabilities, and an elevated risk of wider financial contagion of the sector in the event of widespread supplier failures.
11. We have raised similar concerns in other examples where Ofgem has proposed cross-subsidisation of other segments of the energy sector by placing additional duties on DNOs and/or additional costs on the customers of our distribution network that are unrelated to the services that we provide (for example, our response to the consultation on recovery of heat networks regulation costs from electricity distribution network customers). As with the cost recovery of LRSP payments via DUoS tariffs, any cross-contamination from the retail sector that impacts the charges that our customers pay for the use of the distribution network is fundamentally distortive to the apparent cost of our networks and the services that we provide.
12. Our responses to the specific consultation questions that Ofgem has posed are attached as **Appendix 1** to this letter. We would be happy to engage with your team to provide further details on any of our responses, or to offer further views on SoLR Levy Offset proposals. We will continue to engage constructively with Ofgem on policy development to the benefit of our customers and wider consumers.

Yours sincerely,



Patrick Cassels

Head of Network Commercial, SSEN Distribution

Appendix 1: Responses to Ofgem's questions

This section of the response should be read in conjunction with the above covering letter, which provides further context and detail relating to our responses to Ofgem's specific questions below.

Question 1: Do you agree with our problem statement?

Response: We recognise the complexities and challenges associated with recovering residual value from failed energy suppliers and returning recovered value to consumers. We support the intent behind Ofgem's proposals; however, we do not believe that DNOs are the appropriate party to carry out this role. We believe that this would be better resolved through changes to retail arrangements and the supply licence. The consultation does not sufficiently justify why DNOs are the appropriate party to carry out this role rather than suppliers, nor does it provide sufficiently detailed information on how these arrangements would work in practice for us to be able to meaningfully comment on the impact on our customers and stakeholders.

Question 2: What are your overall views on whether the proposal would deliver on the aims of the SoLR levy Offset?

Response: The consultation offers no details on the evidence base of residual value that it may be possible to recover for consumers under these proposals. It is therefore unclear that there is sufficiently material value, net of costs, that could be recovered, and which would justify the introduction of these obligations. We are additionally concerned as a matter of principal that Ofgem is considering putting additional unrelated policy costs and duties relating to the retail sector onto DNOs, which we believe is counter to the established structure of the industry and would be both unnecessary complex and inefficient whilst introducing new risks for consumers. We do not agree that it would be appropriate for DNOs to be obligated as a condition of their licences to enter a deed with suppliers for costs that are unrelated to the distribution network services that DNOs provide. If obligations are to be placed on DNOs, they must be fully detailed in the licence condition and subject to due statutory consultation process.

The proposals must properly consider the broader cost/complexity/financial risk implications associated with moving responsibilities and costs from the energy retail segment onto distribution networks, and it must be demonstrated that this will offer value for consumers. This must be more thoroughly considered. We are highly concerned at the lack of detail on what these proposals would mean in practice for DNOs and the customers of our networks, including the lack of a comprehensive assessment of areas such as accounting treatment, financial impact, and the remuneration mechanism for any additional costs to DNOs, and ultimately, our customers.

We note that any changes would have to be properly funded and that this change would likely impact numerous aspects of our financial reporting to Ofgem (for example, the Price Control Financial Model, Regulatory Finance Performance Reporting, and other areas).

Question 3: What are your views on the proposed option of network companies being creditor, as opposed to other alternatives?

Response: We do not believe that it is appropriate for distribution network companies to be assigned the role of debt recovery agent for costs relating to the retail sector that are unrelated to the costs of the distribution network service that our businesses provide. Artificially assigning distribution network companies the role of 'unsecured

creditors' to failed suppliers marks a significant departure from the established operational framework of the energy sector, counter to the historical unbundling of energy retail and electricity distribution. It is important to retain a clear separation of energy retail and electricity distribution issues, responsibilities and balance sheets. The proposal risks introducing potential for contagion effects in the event of widespread supplier failures. It introduces an additional layer of financial risk and complexity that is fundamentally unnecessary versus much simpler, efficient solutions in the retail sector that could be introduced to recover residual value.

It would be fundamentally inefficient for all fourteen electricity distribution network licence holders and eight gas distribution licence holders to pursue claims with the failed supplier. The appointment of a 'lead' network for the claims would add an additional layer of complexity and further convolutes the arrangements – creating more cost for consumers and additional risk. We believe this significantly undermines the case that it would be efficient to assign these responsibilities to network companies.

In comparison, the appointed SoLR would be well placed to pursue the recovery of residual value in the first instance, under a much simpler and more streamlined set of commercial arrangements that is more likely to deliver net value back to consumers.

This could be achieved by making changes to the supply licence regarding the obligations of solvent suppliers (including enduring arrangements that could be enforced by the SoLR after the failed supplier's licence has been revoked), and/or introduced as a requirement of the SoLR appointment process. This would have the advantage of a much simpler process with fewer parties involved in the initial debt recovery process, without a requirement for a separate deed. This would leverage the existing expertise within suppliers relating to credit management and debt recovery, alongside their first-hand experience of the structure and operation of a retail supply business.

Question 4: 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?

Response: The positioning of DNOs as 'unsecured creditors' in the event of a supplier's insolvency presents significant concerns regarding the realistic prospect for recovery of costs. This status would substantially diminish the likelihood of DNOs recovering owed amounts. The consultation offers no evidence of the potential value that could be recovered for consumers, which would have to be counterbalanced by the additional costs that DNOs would incur under these proposals that also have to be recovered. Our understanding is that unsecured creditors would be allocated a proportionate share of any residual value across the pool of creditors. This could potentially mean all network companies having to individually participate in the arrangements as part of the creditor pool, which would have to be separately rationalised, adding a further layer of complexity and additional administrative cost and risk.

We do not believe that this would be an efficient solution that offers value for consumers compared to the alternative of a supplier-led option.

Question 5: 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?

Response: We agree in principal that Ofgem's consent for a SoLR to make an LRSP claim to the distribution networks could support a creditor claim as proof of debt, however, this is something that Ofgem must confirm

based on input from the relevant insolvency practice expertise before introducing any changes to regulatory policy. We note that this would have the added effect that when an LRSP claim is not submitted – e.g. if the appointed SoLR chooses to absorb these costs – a claim as a creditor under the SoLR Levy Offset would not apply.

Question 6: What are your views on the deed as it is currently drafted?

Response: As per the body of our covering letter, it remains unclear from the consultation under which powers and/or duties Ofgem considers that it can compel entry into this deed as a requirement of the distribution licence condition – this is something that must be clarified. If obligations are to be placed on DNOs, they must be fully detailed in the licence condition. A requirement through a licence condition to enter into an unspecified agreement would be highly unusual. It is also highly questionable that the Authority has the legal power to allow it to impose such licence conditions. Subject to further clarification, there remain numerous unaddressed practical issues regarding the accounting treatment of these costs and broader legal considerations relating to the deed itself.

Question 7: 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.

Response: We are unclear from the consultation what powers and/or duties that Ofgem would apply to introduce agreement to the proposed deed via a new condition of the distribution licence. This is fundamental to the introduction of these arrangements and must be clarified. There are numerous detailed practical questions that are not addressed in the consultation relating to the critical details such as the financial accounting treatment of these costs, the ability of DNOs to use of Ofgem's consent to SoLR levy costs as 'proof of debt' in insolvency proceedings, appropriate funding arrangements, and clarity on regulatory finance treatment and reporting. These issues require further expert input (including from those with experience in insolvency practices) and a substantially more detailed explanation and justification than is offered in the consultation. At present, there is insufficient detail for us to be able to comment in meaningful depth on the proposed wording of the deed or its impact without this clarity. We are therefore unable to support it as currently proposed, based on the limited information provided.

The proposal does not fully offer address the concerns that Ofgem has raised with respect to the current SoLR arrangements given insufficient consideration of the impacts this would have on network companies. Any licence changes for networks should only be necessary to ensure that any SoLR amounts are a directly passed through to suppliers (and consumers) via network charges. We additionally note that additional provisions may be required in the supply licence to ensure that consumers see a return of this money from suppliers.

Question 8: 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?

Response: While the proposal ostensibly aims to deliver benefits to consumers by recovering some of the costs relating to supplier failures, it lacks a comprehensive analysis of the potential risks and financial impacts on DNOs and, by extension, DNO customers and wider consumers. This issue requires a balanced approach which properly evidences and evaluates the benefits and drawbacks of the proposals. This must include a thorough outline of the practical concerns we have raised with respect to accounting treatment, additional allowances for DNOs to carry out these duties given the administrative costs, and potential financial risks that DNOs would be required to take on should Ofgem proceed with its proposals.