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Sent by email to: solrlevyteam@ofgem.gov.uk

Dear David

SoLR Levy Offset Policy Consultation¹

Centrica welcomes the opportunity to respond to this consultation. Our responses to individual consultations are set out in the attached appendix and our overall views are summarised briefly below.

We strongly support the aim of addressing the clear unfairness that arises where shareholders of a failed supplier may receive a cash distribution from surplus assets in the company while consumers as a whole bear the costs arising from business failure. Ofgem is right to consider ways to address this situation while recognising that it cannot entirely eliminate the risks and fairness issues.

We broadly support Ofgem's proposal for a Supplier of Last Resort (SoLR) levy offset whereby network operators become unsecured creditors of failed supplier estates in respect of SoLR levy claims. However, we think Ofgem can and should simplify the proposal by applying it to all categories of SoLR cost rather than carving out customer credit balances (CCBs) as currently proposed. Amending the proposal in this way will result in a more straightforward and efficient process which is still consistent with Ofgem's overall aim.

There is one area where we would welcome further clarification. This concerns the interaction of the SoLR levy, the proposed SoLR levy offset and the timescale for winding up the failed supplier's estate. We note that winding up can, in some cases, take considerable time and that Ofgem intends to embed the multi-round SoLR levy claim process to allow for interim claims subject to later true-up. However, our query concerns cases where administrators or liquidators move to wind up before final true-up of SoLR levy claims has concluded, even if Ofgem's approval of initial claims allows network operators to submit a

¹ [SoLR Levy Offset Policy Consultation | Ofgem](#)

proof of debt ahead of wind-up. We assume that SoLRs would still be able to submit subsequent claims until final true-up has taken place irrespective of whether the failed supplier's affairs have been wound up, albeit that network operators would have to recover any further levy costs from customers in this case. However, we would welcome confirmation on this point prior to a statutory consultation.

Yours sincerely

Don Wilson

Market Design and Policy

Appendix – consultation questions

Q1. Do you agree with our problem statement?

We agree with the problem statement. Moreover, we note that the fairness issue Ofgem raises also bears on incentives for suppliers to behave responsibly. The potential for the shareholders of failed suppliers to realise a surplus while exposing consumers to some of the costs associated with their failure contributes to moral hazard which may incentivise undue risk taking through pursuit of reckless business models. As such, measures which seek to mitigate this market failure are welcome.

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

We broadly support Ofgem's proposal but believe it should be further simplified in one respect to enhance efficiency and effectiveness. Ofgem's current proposal envisages that Distribution Network Operators (DNOs) act as unsecured creditors in respect of all cost categories except customer credit balances, which the SoLR may pursue in parallel – also as an unsecured creditor. This requires DNOs to strip credit balances out of any claim they make against the estate of a failed supplier while also obliging the SoLR to pursue a separate claim, which is inefficient and unnecessary.

Currently, to the extent a SoLR is successful in any claim against the estate of the failed supplier for CCB costs which it has duly claimed via the SoLR levy, any dividend from the estate must be returned to customers via DNOs as part of a final true-up with Ofgem. It would be more straightforward, and efficient, not to treat customer credit balances differently from other categories of SoLR cost. Ofgem can validate CCBs (or any other category of costs) as part as its consideration of SoLR levy claims. Adopting this approach does not require provision of any additional information to that already provided to Ofgem under the current SoLR levy claim process so would not result in additional administrative burden for SoLRs or for Ofgem.

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

On balance, we agree that network companies are the right vehicle to act as creditor.² Network companies are well capitalised and are less likely in general than suppliers to exit the market (which is a real possibility for suppliers given the extended multi-year timescale it may take for the claims and resolution process to complete). DNOs are necessarily involved in SoLR claims in any event and the additional administration potentially involved in becoming an unsecured creditor appears minimal. In contrast, if suppliers were required to conclude deeds with all other suppliers this would involve considerable additional cost and complexity given the potential suppliers to enter or exit the market over time. Enabling DNOs to act as unsecured creditors offers the possibility for faster recovery and repayment of costs to consumers, especially if interim claims are paid.

² We note, however, that Ofgem itself already acts as an unsecured creditor in relation to Renewable Obligation (RO) liabilities, suggesting there are no insuperable barriers to Ofgem itself taking on this role as an alternative.

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?

On balance, we agree with Ofgem's assessment that unsecured creditor status for networks is the appropriate place in the insolvency waterfall, given the potential for unintended consequences if status is elevated above that level. We agree also with Ofgem's assessment that subordinating the claim is not appropriate since it would limit the amount that can be recovered and the benefit that can be achieved for consumers.

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?

We agree that Ofgem should validate that the costs networks seek to claim from failed supplier estates do not exceed the costs faced by SoLRs arising from their obligations under a Last Resort Supply Direction. However, we do not think the amount networks can claim should necessarily be limited to the amount Ofgem approves for the SoLR levy (which may be lower) or that levy claims in respect of CCBs should be netted off from the amount of any claim by networks against failed supplier estates.

We recognise that Ofgem has previously sought to minimise the quantum of costs to be claimed via the levy by encouraging prospective SoLRs to absorb costs as part of their bid. However, this approach pre-dates the possibility now being canvassed of recovering costs from the shareholders of failed suppliers rather than from customers. Ofgem's present proposal will not fully succeed in its aim of addressing unfairness if the shareholders of failed suppliers remain arbitrarily shielded from particular categories of cost and risk. As noted above, exposing shareholders of failed suppliers to such costs and risks is important not only to mitigate costs to customers but also to address underlying moral hazard, which in turn is important to encourage responsible business practices and reduce the risk of supplier failure and cost mutualisation in the first place.

Our experience as a SoLR is that the possibility of successful claims against failed supplier estates is as an unsecured creditor remains too uncertain to be relied on when bidding to become a SoLR. SoLR bidders may still commit to absorbing some costs, in whole or in part, as part of the competitive process for selecting a SoLR but it does not follow that any costs a SoLR absorbs should not be (potentially) recoverable from failed supplier estates.

Ofgem currently expects SoLRs to pursue claims for CCBs against failed supplier estates as unsecured creditors without restricting the quantum to the amount it has approved as a SoLR levy claim. It would be more efficient and straightforward to enable DNOs to claim gross costs and administer the return of any dividend through network charges without requiring SoLRs to submit potentially competing unsecured creditor claims in respect of CCBs.

We note that the interests and priorities of networks and SoLRs as unsecured creditors are not necessarily aligned. Views may potentially differ, for example, over matters such as the process and timescale for winding up an estate (which may require unsecured creditors to vote). Such potential conflicts could be avoided by allowing DNOs to lead in respect of all SoLR costs without netting off any amount not approved as a levy claim. If administrators require comfort that they will not be subject to parallel claims in respect of the same costs Ofgem could potentially require undertakings from SoLRs not to pursue claims that will be pursued by networks (although the itemisation already required to support claims from

unsecured creditors arguably provides sufficient protection against inadvertent admission of duplicate claims).

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

We consider that the draft deed of undertaking broadly reflects and implements Ofgem's consultation proposal to provide network companies with a right to claim the aggregated amount specified in relevant LRSPs from a failed supplier in an insolvency. For that purpose, we make the following observations:

Paragraph 3.5 of the draft deed sets out that no action by a network company will prejudice or affect its rights against the failed supplier. We ask that the drafting is amended to clarify that this applies to "rights against the Supplier provided herein this Deed."

The draft deed also determines the amounts that can be claimed by a network company in reference to a valid claim under a LRSP, in accordance with SLC9. We therefore request that where Ofgem seeks to modify SLC9, or any other relevant licence condition, it will also proactively consider the impact on suppliers in respect of their obligations under the deed of undertaking and consult accordingly.

As already stated, we strongly believe that Ofgem's proposals should not seek to exclude CCBs or other relevant costs a SoLR may agree to honour and thus absorb. Failed suppliers must be liable for the full cost associated with supplying its customers as this addresses the moral hazard that following an insolvency a failed supplier may retain any residual value that could have been returned to consumers. It would be simpler and more efficient for these amounts to be claimed and recovered through network companies. We would therefore invite Ofgem to incorporate our suggestions into its subsequent consultation proposals.

In respect of the draft deed, we request that the definition of "Last Resort Supply Payment Liability" be amended by deleting the phrase "excluding the cost incurred by the SoLR in honouring Customer Credit Balances."

In accordance with SLC9 of the supply licence, a LRSP reflects the amount claimed by a SoLR following Ofgem's consent, or an adjusted amount as Ofgem may determine. The figure will reflect the amount a SoLR will recover apportioned between network companies minus the amounts a SoLR has decided to honour. In practice the gross total costs and liabilities are provided to Ofgem in respect of a supplier's bid to be appointed as a SoLR. SLC9 does specify what must be included in LRSP. However, it does not preclude an LRSP from not only stating the amount to be paid by a network company, but also separately including any additional Ofgem approved amount which a SoLR has agreed to honour (albeit SLC9 may be amended accordingly for clarity). We also note that this does not appear to be inconsistent with network company licence conditions in respect of last resort supply payment claims.

We do acknowledge that any amounts to be honoured by SoLRs do not automatically represent a debt owed to network companies capable of being claimed in an insolvency. However, as noted above CCBs can and do form part of levy claims already and there is a case for considering whether any costs absorbed by SoLRs could also be included in claims against failed supplier estates by DNOs, especially if those SoLRs can commit not to make parallel claims. This is with the intention of providing network companies with a right to

recover those amounts in an insolvency. Any amounts received can then be returned to consumers via network companies.

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.

As Ofgem has not provided any detail on the proposed licence changes at this stage we reserve the right to comment on any draft changes in due course. For present purposes, however, we ask that Ofgem considers the proposals set out in this response to strengthen and simplify its proposal by not carving out CCBs and instead enabling DNOs to claim gross costs which have been duly validated rather than restricting the quantum to approved levy claims at any point in time.

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?

We think there are likely to be overall benefits and agree with the impact of the benefits Ofgem has outlined. As set out above, however, we believe Ofgem should rethink its proposal to carve out CCBs and instead enable DNOs to claim all relevant SoLR costs from failed supplier estates without netting off CCBs or costs absorbed by SoLRs which fall outside any levy claim.

Subject to these qualifications, we see the proposal for a SoLR offset as a complement to rather than substitute for other financial resilience workstreams which remain vitally important.