

UNC Modification	At what stage is this document in the process?
<h1>UNC 0687:</h1> <h2>Clarification of Supplier of Last Resort Cost Recovery Process</h2>	<div style="display: flex; flex-direction: column; gap: 5px;"> <div style="border: 1px solid green; background-color: #28a745; color: white; padding: 5px; display: flex; align-items: center; justify-content: center;"> 01 Modification </div> <div style="border: 1px solid #17a2b8; padding: 5px; display: flex; align-items: center; justify-content: center;"> 02 Workgroup Report </div> <div style="border: 1px solid #9932cc; padding: 5px; display: flex; align-items: center; justify-content: center;"> 03 Draft Modification Report </div> <div style="border: 1px solid #ffc107; padding: 5px; display: flex; align-items: center; justify-content: center;"> 04 Final Modification Report </div> </div>
<p>Purpose of Modification:</p> <p>To provide clarity on how any costs incurred by the Gas Distribution Networks (Transporters) as part of a Last Resort Supply Payment arising from a Supplier of Last Resort event are recovered from Shippers.</p>	
	<p>The Proposer recommends that this Modification should be:</p> <ul style="list-style-type: none"> considered a material change and not subject to Self-Governance assessed by a Workgroup. <p>This Modification will be presented by the Proposer to the Panel on 18 April 2019. The Panel will consider the Proposer’s recommendation and determine the appropriate route.</p>
	<p>High Impact: Shippers</p>
	<p>Medium Impact: Gas Distribution Networks</p>
	<p>Low Impact: CDSP</p>

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Timetable			Systems Provider: Xoserve
The Proposer recommends the following timetable:			 UKLink@xoserve.com
Initial consideration by Workgroup	10 May 2019		Other: Gareth Evans (Waters Wye Associates)
Workgroup Report presented to Panel	15 August 2019		 gareth@waterswye.co.uk
Draft Modification Report issued for consultation	15 August 2019		 telephone
Consultation Close-out for representations	06 September 2019		07500 964447
Final Modification Report available for Panel	09 September 2019		
Modification Panel decision	19 September 2019		

1 Summary

What

In the last 12 months there have been a number of Supplier of Last Resort (SoLR) events that have resulted in claims from SoLR suppliers for their outstanding costs (Last Resort Supply Payment or LRSP). At present there is little detail in the gas Transporter licence on how these costs are recovered from the wider shipper community, outside of it being recovered via transportation charges.

Why

As has been highlighted in the electricity market, the lack of detail on how costs are allocated to customers can potentially create confusion on how these costs are apportioned. In addition, it also means that customers may end up cross-subsidising SoLR events from other market sectors.

How

It is proposed that a new customer charge, the SoLR customer charge, is introduced into the Gas Transportation charging statements. This new charge will be split by domestic and non-domestic Charging Codes. The charge, which will be on a Supply Meter point basis, will be calculated to recover the costs originating from each market sector, with mixed portfolios allocated by market sector.

2 Governance

Two LRSP claims have been approved since January 2018. In both cases the materiality of the claim amounts to around £5.9m for the gas market. This clearly demonstrates that any change on how these costs are allocated will have a material impact on Shippers and therefore competition in, or commercial activities related to, the shipping, transportation or supply of gas so this Modification will require Authority Direction.

Requested Next Steps

This Modification should

- be considered a material change and not subject to self-governance
- be assessed by a Workgroup.

3 Why Change?

Background to SoLR events

In the last couple of years there have been a number of supplier failures resulting in the use of the Supplier of Last Resort (SoLR) process to reallocate the customers of the failing supplier to another licence holder (SoLR supplier). A SoLR supplier can claim any additional costs over and above what it expects to recover from the transferred customers, in accordance with Supplier Licence Condition 9. This can include credit balances outstanding for domestic customers; non-domestic customer credit balances are not protected. The SoLR costs will then be recovered from Shippers via Transporters.

To date, Ofgem has undertaken an auction process to determine who the SoLR supplier will be, which means that the amount of cost to be recovered from the industry varies, as set out below:

Date	Company subject to SOLR	SOLR awardee	Costs claimed from industry
November 2016	GB Energy Supply	Co-Operative Energy	Yes – £5.76m from gas, £7.72m electricity. Note this decision was made in March 2018.
January 2018	Future Energy	Green Star	No – Ofgem did commit to covering costs from levy, but no claim has occurred.
July 2018	National Gas and Power Limited	Hudson Energy	Unknown, no specific reference in decision.
July 2018	Iresa	Octopus Energy	Yes - £5.92m gas, £7.24m electricity
September 2018	GEN 4U	Octopus Energy	Unknown
October 2018	USIO	First Utility	Yes. – First Utility committed to the lowest amount
November 2018	Extra Energy	Scottish Power	Yes – “partly by Scottish Power and partly by industry levy”.
November 2018	Spark Energy	OVO Energy	Yes – “partly by OVO Energy and partly by industry levy”.
December 2018	OneSelect	Together Energy (Eddington Energy)	Yes– “partly by Together Energy and partly by industry levy”.
January 2019	Economy Energy	OVO Energy	No - Ovo committed to paying credit balances in full.
January 2019	Our Power	Utilitia	No - Utilitia committed to paying credit balances in full
March 2019	Brilliant Energy	SSE	Yes.

This indicates the likelihood of a number of further material SoLR claims over the coming years, supporting the need for a specific cost recovery mechanism.

LRSP process

Once a supplier is chosen Ofgem will then rapidly transfer the customers via Xoserve to the new supplier. SoLR suppliers then make a claim for a Last Resort Supply Payment (LRSP) to cover its costs. For the two LRSP claims made to date, domestic credit balances have been the largest item (note that the values quoted are for both electricity and gas):

Date	Co-Operative Energy	Octopus Energy
Credit Balance component	£10.93m	£10.98m
Total	£14.90m	£13.2m

After an LRSP has been approved by Ofgem, the gas Transporters then reimburse the SoLR supplier and recover the costs through transportation charges in accordance with Licence Condition 48. At present these costs are split between the Distribution Network Operators (DNOs) on a Supply Meter Point basis. These costs will then be added to the allowed revenue that each DNO is allowed to recover as a generic cost.

There is currently little detail in how this additional allowed revenue recovery should be handled, with no specific process set out in either the UNC or the gas transportation charging methodologies. For instance, it does not differentiate between market sectors though each market sector has different levels of protection. Though to date any LRSP claims have been treated consistently by each DNO, it is currently up to each DNO as to how the LRSP costs are incorporated into their charging methodologies.

The same issue exists in the electricity market, which has resulted in differing recovery processes being undertaken across the DNOs with some assigning SoLR costs to the market sector from which they originated via Line Loss Factors.

To ensure appropriate cost apportionment and alignment with the electricity process, there is a need to bring the same level of clarity to any gas LRSP claim processes.

4 Code Specific Matters

Reference Documents

Gas Distribution Network Operator Charging Methodologies

<https://www.gasgovernance.co.uk/index.php/DNcharges>

Ofgem SoLR guidance <https://www.ofgem.gov.uk/publications-and-updates/supplier-last-resort-revised-guidance-2016>

Knowledge/Skills

As this process is reliant on the Ofgem LRSP determination process, it will be of significant benefit for Ofgem to provide some understanding of the process they undertake when approving LRSP payments.

5 Solution

A new specific charge (SoLR Customer Charge) will be created and added to the current Gas Distribution Operators Charging Methodologies. Cost recovery will be based on whether a site is domestic or non-domestic based on market sector flags maintained by Xoserve (as determined at the time of the issuing of the invoice). This allows a more accurate cost-targeting to the market sectors they originate from and is in line with the rest of the SoLR framework, but will require the development of a new charge. We are making the assumption at this stage that Ofgem does not provide any further information to the DNOs outside of the high-level lump sum payment set per meter point.

1. New charging item SoLR Customer Charge to be developed and added to the Gas Transportation Charging Statements, with different Charge Codes for domestic and non-domestic meter points.
2. When directed by Ofgem to recover the costs of an LRSP payment, each Gas Transporter will recover all of the LRSP payment costs via the SoLR Customer Charge.
3. Where no LRSP payments are required for a charging year, the SoLR Customer Charge will be zero.
4. The SoLR charge will be calculated by the following for meter points with the domestic market sector flag indicator:

$$C_{dom\ meter\ point} = \frac{L_{credit}}{M_{dom}} + \left(\frac{L_{residual}}{(M_{dom})} \times \frac{S_{dom}}{(S_{dom} + S_{non-dom})} \right)$$

$C_{dom\ meter\ point}$ = SoLR customer charge per domestic meter point

L_{credit} = Portion of LRSP payment attributable to customer credit balance.

$L_{residual}$ = Portion of LRSP payment not attributable to customer credit balance

M_{dom} = Total number meter points flagged as domestic at calculation in market

$M_{non-dom}$ = Total number meter points flagged non – domestic at calculation in a

S_{dom} = Number domestic meter points of SoLR supplier at time of transfer

$S_{non-dom}$ = Number non – dom meter points of SoLR supplier at time of transfer

5. The SoLR charge will be calculated by the following for meter points with the non-domestic market sector flag indicator:

$$C_{non-dom\ meter\ point} = \left(\frac{L_{residual}}{(M_{non-dom})} \times \left(\frac{S_{non-dom}}{(S_{dom} + S_{non-dom})} \right) \right)$$

$C_{non-dom\ meter\ point}$ = SoLR customer charge per non – dom meter point

$L_{residual}$ = Portion of LRSP payment not attributable to customer credit balance

M_{dom} = Total number meter points flagged as domestic at calculation in market

$M_{non-dom}$ = Total number meter points flagged non – domestic at calculation in a

S_{dom} = Number domestic meter points of SoLR supplier at time of transfer

$S_{non-dom}$ = Number non – dom meter points of SoLR supplier at time of transfer

Worked Example

- Assume 20m domestic meter points, 0.5m non-domestic meter points in market
- Suffolk Energy supplier goes into SoLR with 9,000 domestic and 1,000 non-domestic meter points (as determined by Xoserve at the time of the invoice).
- Total LRSP of £5m, £4m domestic customer credit balances, £1m other costs.

$$C_{dom\ meter\ point} = \frac{4,000,000}{20,000,000} + \left(\frac{1,000,000}{20,000,000} \times \frac{9,000}{(9,000 + 1,000)} \right)$$

$$C_{dom\ meter\ point} = 0.2 + (0.05 \times 0.9)$$

$$C_{dom\ meter\ point} = \text{£}0.245$$

$$C_{non-dom\ meter\ point} = \left(\frac{1,000,000}{500,000} \times \left(\frac{1,000}{(9,000 + 1,000)} \right) \right)$$

$$C_{non-dom\ meter\ point} = (2 \times 0.1)$$

$$C_{non-dom\ meter\ point} = \text{£}0.2$$

6. In the event of multiple LRSP claims falling into a single year, the SoLR Customer Charge will be calculated on the basis of each LRSP claim, but will be aggregated to form a single charge for each Charge Code.
7. DNOs will be required to detail in price notification documents or charging statements expected details on how the SoLR customer charge has been calculated.
8. The mechanisms and timescales for recovery of the SoLR charge will be the same as that of the LDZ Customer Charge.
9. Any under-or-over recovery of the SoLR will be recovered via the “k” balancing mechanism. Though this is not allocated to any specific charge types, considering the low materiality of any such residual amounts we believe this is a proportionate mechanism for any recovery.

6 Impacts & Other Considerations

Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

No impact.

Consumer Impacts

No direct impact, though suppliers will see the transportation costs of supplying customer vary depending on the outcome of any LRSP direction.

Cross Code Impacts

None – currently LRSP payments are not explicitly recovered via IGTs so this Modification does not need to be mirrored in the IGT UNC.

EU Code Impacts

None

Central Systems Impacts

There are likely to be system impacts as Xoserve will be required to develop and maintain a new charging code with associated rules for embedding market sector flags into the invoicing process. This will form part of the Workgroup assessment.

7 Relevant Objectives

Impact of the Modification on the Relevant Charging Methodology Objectives:	
Relevant Objective	Identified impact
a) Save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business;	Positive
aa) That, in so far as prices in respect of transportation arrangements are established by auction, either: <ul style="list-style-type: none"> (i) no reserve price is applied, or (ii) that reserve price is set at a level - <ul style="list-style-type: none"> (I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and (II) best calculated to promote competition between gas suppliers and between gas shippers; 	None
b) That, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;	None
c) That, so far as is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers; and	Positive
d) That the charging methodology reflects any alternative arrangements put in place in accordance with a determination made by the Secretary of State under paragraph 2A(a) of Standard Special Condition A27 (Disposal of Assets).	None
e) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

The Modification has two key benefits. Firstly, it aligns the cost recovery mechanism that is operated in the UNC with the current LRSP process, in which cost apportionment is based on Supply Meter Points and does not include IGT Supply Meter Points, this will ensure cost recovery by DNOs is reflective of the costs incurred. Secondly, it will target the costs that occur from an SoLR event to the market sector in which they originated, so furthering competition.

8 Implementation

No formal implementation date is proposed, however implementation could be soon after an Authority Direction to implement.

9 Legal Text

Text Commentary

Legal Text to be provided.

10 Recommendations

Proposer's Recommendation to Panel

Panel is asked to:

- Agree that Authority Direction should apply
- Refer this proposal to a Workgroup for assessment.