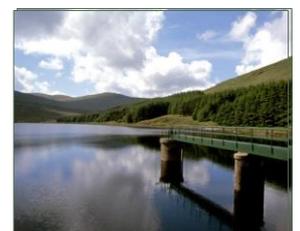


# Supplier of Last Resort (Electricity)

Dealing with Customer Credit Balances

Decision Paper

November 2017



# About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

## Our Mission

Value and sustainability in energy and water.

## Our Vision

We will make a difference for consumers by listening, innovating and leading.

## Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

## Abstract

In May 2017 the Utility Regulator (UR) consulted on the approach to dealing with customer credit balances and deposits, in the event of an electricity supplier failure and the implementation of the Supplier of Last Resort process.

This decision paper reflects on the responses received from industry stakeholders and outlines the rationale for the UR's decisions in relation to the three main issues put forward in the consultation: coverage of protection, customer reimbursement and funding of customer reimbursement.

## Audience

This document is most likely to be of interest to regulated supply and network companies in the energy industry, consumer organisations, community and voluntary organisations, natural gas and electricity consumers, government and other statutory bodies.

## Consumer impact

This policy is likely to have a positive impact on consumers as it is about ensuring consumer credit balances are protected in the event of a supplier failure. It should increase confidence in the market as customers can be assured their deposits or credit balances will be protected in the event their supplier goes out of business.

# 1 Introduction

- 1.1. The primary statutory duty of the Utility Regulator (UR) with respect to electricity is “to protect the interests of consumers of electricity, supplied by authorised suppliers, wherever appropriate by promoting effective competition”. Therefore, we are committed to ensuring that consumers are adequately protected in the event of an electricity supplier failure or insolvency.
- 1.2. As a result of the financial failure and consequent licence revocation of Open Electric in December 2016, and during the ensuing Supplier of Last Resort (SoLR) process that was carried out, the UR identified the issue regarding those customers who have credit balances or deposits with the failing supplier. As the existing SoLR processes do not make provision for dealing with customer credit balances, the UR has consulted with stakeholders to explore options for dealing with deposits and credit balances of customers of the failing supplier.
- 1.3. The consultation paper, entitled “Supplier of Last Resort (Electricity) - Consultation on Dealing with Customer Credit Balances”, was published in May 2017. In this paper the UR explored options for the scope of any potential remedy and options for paying for the reimbursement of customer credit balances and deposits. The UR sought a full consultation with stakeholders to ensure a balanced outcome taking into account respondents views and the UR statutory duty to protect customers.
- 1.4. This decision paper reflects on the responses to that consultation received from industry stakeholders. It also outlines the rationale for the UR’s decisions in relation to the three main issues put forward in the consultation: coverage of protection, customer reimbursement and funding of customer reimbursement.

## 2 Context

### Supplier of Last Resort Event – December 2016

- 2.1 There has been one SoLR event in Northern Ireland to date. The UR was informed on 15 December 2016 that an event of insolvency had occurred in the form of the appointment of an administrator to Open Electric. On 16 December the UR received documentary proof to this effect.
- 2.2 Further to a meeting with the administrator and taking into account the information disclosed at this meeting, the UR was unable to be satisfied that Open Electric had the resources to be able to continue to trade for more than a short period of time, or that there were plans in place which were likely to lead to the sale of the business as a going concern in the immediate future.
- 2.3 The UR was satisfied that, in the circumstances of the insolvency, it was entitled to revoke Open Electric's licence. In addition, it was satisfied that, if it were minded to do so, it would also be entitled to direct the appointment of Power NI to act as the SoLR in relation to the customers of Open Electric, with that direction to take effect from the time of revocation.
- 2.4 The licence revocation formally took place at 00.01 on 18<sup>th</sup> December 2016 and the SoLR industry procedures formally came into operation at that time.
- 2.5 The SoLR procedure ran smoothly and successfully resulting in a seamless transfer of the customers of the failed supplier to the nominated supplier. This vindicated the SoLR arrangements in Northern Ireland and the continuity of consumer protection and supply that those arrangements deliver. The existence of a nominated SoLR, which has tested all IT systems and associated processes on a yearly basis with NIEN, ensures that all precautions against an unsuccessful process have been taken.

- 2.6 Once the process was completed, the UR conducted a “Lessons Learned” exercise to identify areas to improve the process for any future incidents and examine a number of issues that emerged as part of the December 2016 event. The exercise highlighted that a key immediate item which needed addressing was to consult on how to deal with the customers who have deposits and credit balances with the failing supplier.
- 2.7 During the SoLR event of December 2016 the UR decided that all affected Credit and Direct Debit customers who were in credit with the failing supplier would be recompensed. Power NI agreed verbally with the UR that it would cover the costs of reimbursing customer in credit. However this is not an enduring solution and there is a need to explore various options with respect to how deposits and credit balances of customers of the failing supplier should be dealt with in any future SoLR event.

## **Current Situation**

- 2.8 During the SoLR procedure resulting from Open Electric going into administration it became evident that, in the event of insolvency, there would be financial implications for the failed supplier’s customers.
- 2.9 Most keypad customers will have credit of some sort remaining on their meter, except those that are in the emergency credit phase or have self-disconnected. Keypad customers do not lose this credit in the event their supplier goes out of business as the credit is stored on the meter. The SoLR is responsible for covering the cost of the delivery of energy associated with the credit left on the meters. These amounts can only be estimated and during the SoLR event of 2016, the deemed credit amount was £13 per customer. The aggregate of all the keypad credits then becomes part of the overall credit balance bill.

- 2.10 Some non-keypad customers may also have a credit balance on their account at the time when the licence is revoked. This balance can exist because they had been paying more in direct debits than they have been consuming or they have a deposit held by the supplier.
- 2.11 Following the Open Electric event the UR decided to ensure that all non-keypad domestic customers with a credit balance and/or with an outstanding security deposit would be reimbursed. This was based on the fact that the customer numbers were very low, and therefore the resulting financial outlay was not material.
- 2.12 The reimbursement to consumers was facilitated by the fact that Open Electric provided the nominated SoLR with accurate customer account balance information in order to recompense those customers. This was critically important as without this information reimbursing customers would not be possible. As a result it should be noted that any enduring solution to credit balance management in the event of a SoLR event will be contingent on the failing supplier providing the SoLR with up to date account balance information. To aid this exchange of data it is the UR intention to put in place arrangements that will oblige suppliers to have a part of their general terms and conditions that the customer account data will be transferred to the SoLR in the event of the supplier having its licence revoked.
- 2.13 In the case of a supplier insolvency, as it currently stands, the customer is likely to be treated as an unsecured creditor of the failed supplier. Insolvency law allows a hierarchy of payments where some types of creditors should be paid in preference to others. Secured creditors are generally paid before, and in preference to, unsecured creditors. This means that the customer is unlikely to receive all, or possibly any, of the money relation to their credit balance or deposit back from the failed supplier.

- 2.14 For customers who are in debt, their debt will not follow them to the new supplier. Their situation is a matter for the administrator appointed to the failed supplier.
- 2.15 Therefore as the situation is currently, for Direct Debit (DD) customers, the supplier will likely be holding credit for at least some of the DD accounts and those customers will lose this credit when their account with the failing supplier closes and they move to a new account with the nominated SoLR. In like manner, customers who have paid a deposit on joining the supplier will lose that deposit as a result of the supplier failing and the customer becoming an unsecured creditor.

### 3 Consultation Responses

- 3.1. The UR would like to thank all our stakeholders for their engagement with the consultation. The UR received responses from
- Power NI (the current nominated SoLR),
  - SSE Airtricity (SSE),
  - Consumer Council Northern Ireland (CCNI),
  - National Energy Action Northern Ireland (NEA),
  - firmus Energy (FES)
  - Phoenix Natural Gas (PNGL).
- 3.2. This section details the specific questions that were asked and the consultation responses. It also puts forward the URs decisions and the justification for each decision made.

## Issues Consulted Upon

### Coverage of Protection

- 3.3. Although all customers can be affected by supplier failure, the UR is proposing to implement protection on credit balances for domestic customers only. The first consultation question was:

**Question 1: Do you agree that the scope of any protection measures implemented to resolve issues with regard to outstanding credit balances due to a SoLR event should only apply to domestic customers?**

- 3.4. Three respondents were in agreement that the scope should only include domestic customers. One respondent felt that businesses are likely to be in a position to make their own informed choice, and be aware of the risks about switching to a new supplier. Two other respondents thought the scope should be widened to include small businesses. One would like to see the measures extended to the micro business in the 0-10MWh or 0-50MWh market segments. They suggest that small businesses share characteristics with domestic consumers in their engagement with the energy market. The other was of the opinion that businesses pay higher deposits to suppliers and need confidence that when they enter a contract with a supplier the supplier will remain in situ for the duration of the contract.
- 3.5. There was therefore a small majority in favour of covering domestic customers only. However this is not a straightforward issue and is quite subjective. The precedent in place is that of GB.
- 3.6. Ofgem's approach to credit balances during a SoLR event in GB is for the SoLR to create a 'safety net' which covers the consumers' credit balances.

This safety net is applicable to domestic customers only. Their rationale for this approach is that business customers are better placed to deal with insolvency/administration processes. So it is reasonable to expect a business customer to manage this risk themselves and seek to recoup potential losses as any normal creditor would, in a way that is not so reasonable to expect of domestic customers. This approach is in line with general consumer law. In consumer law, anyone operating a business is deemed to have the ability to make themselves aware of what they are signing up to and to be aware of all relevant consumer laws and apply them in running their business. There is a stark difference from the protection afforded to domestic consumers.

- 3.7. However, Ofgem has in the past identified that small businesses have many of the characteristics of domestics and this seems contrary to the position outlined above. It has been decided that coverage for small businesses will be examined in a wider context and may be introduced in the future but not at this time.

### 3.8. UR Decision

In the case of a SoLR event, the scope of the credit balance protection would pertain to domestic customers only. The coverage for small business can be assessed in the wider consideration of I&C customer protection.

#### Reimbursement

- 3.9. The second issued raised in the consultation is what amount or percentage of the credit balances each customer should receive. The options put forward were:
- a) No reimbursement
  - b) Full reimbursement
  - c) Capped reimbursement

3.10. Respondents were asked which option they considered most suitable.

**Question 2: Which of the proposed approaches do you consider most suitable for resolving the issue of the coverage of the protection for customers with outstanding credit balances**

3.11. Three respondents were in favour of full reimbursement. One of these highlighted that full reimbursement is the only equitable solution that does not differentiate the treatment of credit customers from prepayment customers. Another commented that full reimbursement is in keeping in line with the current position in GB. And another felt that anything less than full reimbursement would reduce customer confidence and be detrimental to the competitive market.

3.12. One respondent did not support any reimbursement stating that choosing the failed supplier was a decision that, involving consideration of financial risk, the customer must be willing to accept. However, if reimbursement were to happen it should be capped.

3.13. Another respondent stated “We believe customers must have confidence that suppliers, certified by the Utility Regulator to operate in the Northern Ireland electricity market, have the necessary financial arrangements in place to cover outstanding credit balances”, which the UR has taken to imply means they are in favour of full reimbursement.

3.14. As part of their safety net, Ofgem offer full reimbursement of credit balance to domestic customers in GB following a SoLR event.

**3.15. UR Decision**

Consumers are to be fully reimbursed for any credit balances and deposits which have been held by the failing supplier.

3.16. This decision makes Question 3 defunct.

**Question 3: If you consider that capped domestic reimbursement is the most suitable approach for resolving the issue of coverage for outstanding credit balances please provide your views on how the capped amount should be calculated.**

#### Funding

3.17. The consultation then focused on where the funding will come from to cover the reimbursement of credit balances and deposits. The consultation paper set out several funding options:

- Industry levy
- Payment by SoLR
- Combination of levy and SoLR
- Bond / Insurance

3.18. Respondents were asked which of these options they deemed most suitable for the reimbursement of credit balances and deposits.

**Question 4: Which of the proposed approaches do you consider most suitable for resolving the issue of payment options for outstanding credit balances.**

3.19. Recognising that the SoLR would be obtaining a new customer base without any of the acquisition costs, but is likely to lose a high proportion of these customers through customer switching, three respondents were in favour of the combination of levy and SoLR approach in principle.

3.20. One respondent was in favour of the industry levy stating “All credit balance payments would be deemed a fair and reasonable pass through cost”.

3.21. The bond or insurance option has been ruled out as the occurrence of a SoLR event is very rare and would be an unnecessary on-going cost to consumers.

### 3.22. UR Decision

The funding for the reimbursement of credit balances and deposits will be via a combination of the PSO Levy and the SoLR.

3.23. It must therefore be decided how to apportion the total credit balances amount between the SoLR and the PSO. Question 5 asked:

**Question 5: If you consider that the SoLR should pay a fixed amount per customer acquired through the SoLR event, please provide views on how the amount paid for each customer should be calculated.**

3.24. Only two respondents offered a credible solution to this question. One noted that the average credit balance payment the SoLR would have to make would likely be £100 per customer and there should be a straightforward split 50/50. The issue with this approach is that the actual total amount due in advance of a SoLR event is unknown. It would be unreasonable to expect the SoLR to pay 50% of an unknown amount. This approach also does not consider the churn rate of the new customers.

3.25. The other respondent suggested taking the variable customer price control parameter within the SoLR's current price control and applying a 50% split with the PSO. Then considering that only around 50% of the newly obtained customers are likely to stay with the SoLR, the SoLR's portion of the variable

customer price control should be 50% of the remaining value. Six months after the SoLR event of Dec 2016, the SoLR had lost 44% of the customers they acquired.

3.26. It should be noted at this stage that a SoLR event happened in GB in 2016. In this event the SoLR agreed to pay 30% of the customer credit balance and deposit bill. This amount was £4.7m. During this event 160,000 customers were affected, implying the SoLR paid just under £30 per customer acquired.

### 3.27. UR Decision

3.28. The UR agrees with the above methodology in principle, however we feel that the SoLR will benefit with the uplift in customer numbers for a considerable time. The UR have decided to apply a 3-year multiplier to the variable price control parameter, which will then be proportioned based on the criteria above. Should the customer variable amount change, or the SoLR become deregulated, this methodology will have to be reviewed again.

3.29. The SoLR's contribution to the credit balance amount, in terms of amount per customer transferred at the time of the SoLR event, will be the customer variable amount in real prices, calculated from the variable parameter in the SoLR's licence, times a 3-year multiplier, portioned to 25%.

3.30. If this contribution is not enough to cover the total cost of reimbursement of credit balances, the remainder of the credit balance amount will be charged through the PSO levy.

3.31. If however the SoLR contribution is greater than the amount required for the reimbursement the difference between the contribution and the credit balance cost shall be used to offset any other SoLR costs that should be

claimed under Condition 23 of the supply licence. This should ensure that the SoLR will make the same contribution per customer regardless of the size of the reimbursement of credit balances amount.

- 3.32. If however the contribution amount is greater than the aggregate of the credit balances amount and any other SoLR costs incurred the effect shall be that there will be no claim for last resort supply payments allowable under Condition 23.

## 4 Other Issues Raised Through Consultation

- 4.1. One respondent proffered an alternative proposal to those outlined in the UR's consultation paper. It suggested that all suppliers be required to provide similar credit cover by way of a Letter of Credit, Parent Company Guarantee, or cash for security against credit balances as part of the certification process. Suppliers should then report on credit balances as part of their quarterly REMM return. The respondent also proposed that the credit rating per supplier be published by the UR to allow customers make informed decisions before entering into contracts. Finally they proposed limiting the amount of credit that can be held on a prepayment meter.
- 4.2. The UR has carefully considered the above proposals and has deemed them to be impracticable in this instance. Issues would arise as to who would facilitate and process the credit cover. Given that the SoLR event is a rare occurrence, the administrative and financial implications of such a process would outweigh the benefits. The UR is also unaware of any other regulator that publishes the credit rating of suppliers and feels this would be

discriminatory against new small entrants who may have yet to build a credit rating. This would thus favour larger suppliers and inhibit the development of a competitive market with constant new entry. Finally the amounts that are held on keypad meters are generally small and are deemed to be £13 in the absence of exact information. This figure was forwarded to the UR by the SoLR and is the result of previous analysis of customer vending practices in NI.

- 4.3. One respondent raised the issue that it is important that customers of the designated SoLR do not end up paying twice to cover the credit balance i.e. as a customer of the SoLR and as a NI customer all of whom contribute to the PSO levy. The UR can confirm that the SoLR will not be able to charge its contribution through its price control and this will avoid customers double-paying. The shareholder will cover the cost of the SoLR contribution and it will not go through the price control.
- 4.4. Two participants from the gas industry responded to the consultation to highlight that a solution in electricity will not be directly transferable to gas. Both provided reasoning for their point of view and their responses will be considered by the UR further as part of the gas SoLR project.