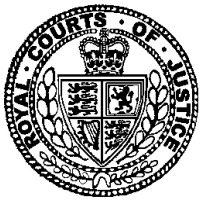

Neutral Citation Number: [2022] EWHC 37 (Admin)

Case No: CO/1552/2021

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
ADMINISTRATIVE COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 11/01/2022

Before :

THE HON. MRS JUSTICE THORNTON DBE

- -

Between :

THE QUEEN **Claimant**

(on the application of SCOTTISHPOWER ENERGY RETAIL LIMITED)

- and –

THE GAS AND ELECTRICITY MARKETS AUTHORITY **Defendant**

- -
- -

Josh Holmes Q.C. and **Azeem Suterwalla** (instructed by **Womble Bond Dickinson (UK) LLP**) for the **Claimant**
Jessica Simor Q.C. (instructed by **The Office of The General Counsel to the Gas and Electricity Markets Authority**) for the **Defendant**

Hearing dates: 10/11/2021 – 11/11/2021

- -

Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

.....

MRS JUSTICE THORNTON

The Hon. Mrs Justice Thornton :

Introduction

1. In November 2018, the energy supplier, Extra Energy Supply Limited ("Extra Energy"), ceased trading. When it failed, the company was supplying electricity to approximately 129,000 electricity customers and gas to approximately 95,000 gas customers. In order to ensure continuity of supply, the industry regulator, Ofgem, appointed ScottishPower Energy Retail Limited ("ScottishPower") to continue supplying customers of Extra Energy, in a role known as 'Supplier of Last Resort' ('SoLR'). The appointment followed a commercial bidding process involving eight companies.

2. This claim arises out of a dispute between Ofgem and ScottishPower as to whether ScottishPower can claim the costs of performing aspects of the role from an industry levy, paid for ultimately by consumers. The payment is known as a Last Resort Supply Payment (LRSP). Whilst Ofgem permitted the majority of the costs sought by ScottishPower (£10.6 million), it did not permit the company to claim the cost of debts of £3.1 million accrued by former Extra Energy customers in respect of energy supplied to them by ScottishPower after its appointment as Supplier of Last Resort.

3. ScottishPower claims that Ofgem's decision to refuse its claim for customer debt is unlawful on three grounds:
    (1) Ofgem fettered its broad discretion by taking an "in-principle" decision that debt costs were not within the scope of a LRSP. It therefore "closed its mind" to allowing this aspect of the claim. Alternatively, Ofgem did not explain to ScottishPower that it had a specific policy in respect of debt costs, which was not referred to in its published criteria for assessment of LRSP claims, which rendered the decision procedurally unfair.
    (2) The decision was irrational. Ofgem failed to follow its published criteria for assessing claims. In addition, Ofgem rejected the claim on nonsensical grounds, namely that debt costs fell outside the basis on which ScottishPower was appointed as SoLR; they were a category of costs which a SoLR should not be able to recover; and it was necessary to rule out the recovery of debt costs, as a matter of principle, in order to protect the interests of consumers.
    (3) Ofgem failed to give adequate reasons for its decision.

4. In response, Ofgem contends that it has a broad discretion whether to allow a claim for an LRSP to be made against the industry levy. It exercises its discretion on a case by case basis. It uses published criteria as part of a wider overall analysis of the merits of any application, but the criteria are not an empirical, complete or exclusive tool. Ofgem did not have a policy regarding the recovery of customer debt because the claim was novel. It had regulatory policy reasons for refusing to protect ScottishPower from debt accrued after the transfer of customers, which included the wider implications for the future of the market, as well as reasons specific to ScottishPower, including ScottishPower's failure to indicate it proposed to make any such claim when it bid for appointment as SoLR. ScottishPower's claim amounts, in effect, to an impermissible attempt to re-argue the merits of a decision it disagrees with.

Regulatory framework

5. The Defendant, the Gas and Electricity Markets Authority (GEMA) is the independent regulator of gas and electricity markets in Great Britain, established by the Utilities Act 2000. It is a non-ministerial government department. Its functions, so far as relevant to this claim, are provided for in the Gas Act 1986 and the Electricity Act 1989. It is funded largely by the network companies, which are licensed by it to participate in the gas and electricity markets. The Defendant's day to day functions are carried out by the Office of the Gas and Electricity Markets Authority (Ofgem), also a non-ministerial government department and an independent national regulatory authority. GEMA provides strategic and policy direction for Ofgem. Ofgem engaged in all relevant correspondence and decision making in this case and is therefore referred to throughout this judgment, in lieu of GEMA.

6. Pursuant to s. 4AA of the Gas Act 1986 and s. 3A of the Electricity Act 1989, the principal objective of Ofgem is to protect the interests of existing and future consumers, in relation to the supply of gas and electricity, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the provision of gas and electricity. In particular, section 3A(1) of the Electricity Act (as amended and repeated in all material respects in the Gas Act) provides:

> *"3A.(1) The principal objective of the Secretary of State and the Gas and Electricity Markets Authority (in this Act referred to as "the Authority") in carrying out their respective functions under this Part is to protect the interests of existing and future consumers in relation to electricity conveyed by distribution systems or transmission systems.*
>
> *(1A) Those interests of existing and future consumers are their interests taken as a whole, including…. (b) their interests in the security of the supply of electricity to them;"*

Licensed suppliers of gas and electricity

7. Subject to limited exemptions, suppliers of gas and electricity to any premises are required to hold a licence permitting the supply (ss 5 and 7A Gas Act 1986 and ss.4 and 6 Electricity Act 1989). Accordingly, ScottishPower supplies energy to approximately 5 million householders and businesses in Great Britain, pursuant to its licence. A licence to supply gas or electricity is subject to Standard Licence Conditions (s. 8 Gas Act 1986 and s. 8A Electricity Act 1989). The Standard Licence Conditions are determined and published by the Secretary of State.

Supplier failure - the appointment of a Supplier of Last Resort

8. From time to time, companies in competitive markets fail. This applies as much in relation to the gas and electricity supply markets as it does to other markets. Unlike other areas of the market, gas and electricity are services that are generally regarded as essential.

9. The failure of a supplier may impact on a range of groups including its consumers, the wider market and other consumers. Accordingly, Ofgem has discretionary powers that enable it to address these consequences. In particular, Ofgem can direct any gas or electricity supply licensee to take over responsibility for a failed supplier's customers. The role is known as 'Supplier of Last Resort'. Generally speaking, energy suppliers are open to taking on the role of SoLR because they acquire a large number of new customers, a significant percentage of whom may remain with them over the longer-term. The effect is that the process of appointing a SoLR tends to be a competitive one, albeit that it takes place over a very short period of time.

10. Standard Licence Condition 8 of the Gas and Electricity Supply licences provides for Ofgem to issue a Last Resort Supply Direction to a licensee to take on the role of SoLR. In considering which supplier to appoint as SoLR, Ofgem must be satisfied that the SoLR can supply additional customers without significantly prejudicing its ability to continue to supply its existing customers and to fulfil its contractual obligations for the supply of gas or electricity (Condition 8(1)(b)). The obligations on a SoLR include an obligation to inform customers of the failed supplier that the failed supplier has ceased supplying the customer, and the customer is now supplied by the SoLR (Condition 8.6).

11. Ofgem's criteria for the selection of a SoLR are set out in guidance titled *"Guidance on supplier of last resort and energy supply company administration orders".* Ofgem's stated policy preference is to appoint a SoLR who has volunteered for the role. A SoLR should have robust arrangements in place that will enable it to supply the failed supplier's customers economically and efficiently. A SoLR must be able to operate the relevant change of supplier process and bring the customers onto the SoLR's own systems promptly, in order to minimise disruption to customers and other industry participants.

12. The process for appointing a SoLR starts with Ofgem gathering information to decide on an appropriate course of action. It collects information about the failing supplier's portfolio, including a copy of the standard contract entered into by the supplier with customers, a description of the financial position of the company and customer details.

13. Ofgem then provides high-level, aggregated portfolio information about the failing supplier to potential SoLRs to enable them to assess their ability to supply the additional customers. To understand the terms on which suppliers are willing to act as SoLR, Ofgem requires potential SoLRs to provide information about a number of issues, including customer service. This is done via a Request for Information (RFI). Questions asked of potential SoLRs include:

    - How the supplier would meet the obligations and whether it would make any LRSP claim and if so, for what categories of need and with what upper limit.

- Details of the arrangements the supplier will make to manage the change of supplier process and the length of time it is likely to take to transfer all the customers of the failed supplier.
- The arrangements to be made with the customers of the failed supplier, including how customers will be informed about what has happened and how customer enquiries will be dealt with.

14. The selection of a SoLR necessarily takes place quickly. For that reason, Ofgem asks suppliers to update it on a regular basis as to their willingness to be considered as a potential SoLR.

15. Once a SoLR is appointed, it is for the SoLR to decide the best way to transfer customers to its portfolio. Prior to transfer, however, the SoLR has a deemed contract with each of the failed supplier's customers (pursuant to paragraph 3 of Schedule 6 to the Electricity Act 1989, and paragraph 8 of Schedule 2B to the Gas Act 1986). The SoLR is therefore able to charge them for the gas or electricity they use from the date of the SoLR's appointment, at the value proposed by it in its bid. The deemed contract rate applies until transferred customers have agreed a replacement contract with the SoLR or another supplier. The 'deemed contract rate' cannot exceed the costs of supply and a reasonable profit.

Claims for Last Resort Supply Payments

16. Condition 9 of the Standard Licence Conditions permits a SoLR to make a claim for the otherwise unrecoverable costs that they have incurred in being a SoLR. The permitted costs are referred to as a 'Last Resort Supply Payment'. Condition 9 provides that:

> ***"Ability to make claim***
> *9.1 If the licensee has received the Authority's consent under paragraph 9.5, it may make a claim for a Last Resort Supply Payment, under standard condition 38 (Treatment of Payment Claims for Last Resort Supply) of the Distribution Licence, from each Relevant Distributor.*
>
> *9.2 The licensee must not make a claim for a Last Resort Supply Payment if, and to the extent that, it has waived its ability to do so by Notice given to the Authority before the Authority gave it a Last Resort Supply Direction.*

> …
>
> *9.4 The total amount of the Last Resort Supply Payment… to be claimed by the licensee must not exceed the amount by which:*
>
> *(a) the total costs… reasonably incurred by the licensee in supplying electricity to premises under the Last Resort Supply Direction and a reasonable profit,*
> *plus*
> *(b) any sums paid or debts assumed by the licensee to compensate any Customer in respect of any Customer Credit Balances,*
>
> *are greater than:*
>
> *(c) the total amounts recovered by the licensee through Charges for the Supply of Electricity to premises under the Last Resort Supply Direction (after taking all reasonable steps to recover such Charges).*
>
> *9.5 If the Authority considers it appropriate in all the circumstances of the case for the licensee to make the claim notified to it in accordance with paragraph 9.3, the Authority will give its consent to the licensee.*
>
> *9.6 The Authority may determine that an amount other than the one calculated by the licensee is a more accurate calculation of the relevant amount."*
>
> (Emphasis added)

17. Where Ofgem agrees that an LRSP claim can be made it is funded initially by the network operators, and subsequently socialised by a change to the network operators' general charges for use of their networks, which is ultimately passed on by network users to end customers.

18. Ofgem's guidance recognises that the role of SoLR represents a significant logistical challenge to a supplier. The supplier is likely to incur increased administrative costs and will have to implement additional energy purchasing arrangements. These will have to be activated and managed within a very short period of time. However, the guidance also recognises that there are potentially valuable commercial benefits to a SoLR. It has the opportunity to convert the customers it has acquired as a SoLR to normal contracts and will

not have the usual costs of acquiring new customers, such as paying commission to price comparison websites.

19. The guidance goes on to explain Ofgem's position on LRSPs as follows:

> *"2.26 We would generally prefer a SoLR not to make a claim via these arrangements for costs it has incurred carrying out its role although we recognise that circumstances may exist which would justify a departure from this general rule. The circumstances of every supplier failure are different and there may be some where a SoLR incurs costs which would not otherwise be recoverable. An efficient SoLR should be able to minimise its exposure to these costs.*
>
> *2.27. Following appointment of a SoLR that had not waived its right to make a claim, we will decide on a case-by-case basis whether it might be appropriate for a SoLR to make a claim on the levy. We would consider whether the amount of any claim or the reasons for any claim were reasonable. For example, we may in certain circumstances consider it appropriate to approve the claim where it relates to costs associated with the protection of customers who held a credit balance with the failed supplier as outlined above."*
>
> (Emphasis added)

20. The reference to credit balances in the penultimate line of the extract above is a reference to the problems arising from the common position whereby some customers pay monies to their supplier in advance towards their future energy supply. Most often this arises where customers pay by direct debit and the amounts paid monthly exceed the energy which they have so far used at any given point in time. If a customer's supplier then becomes insolvent, the customer will usually only have an unsecured claim against the supplier, which in practice will likely mean that they lose their credit balance. To protect customers from this and to maintain consumer confidence in the energy market, Ofgem will wherever possible seek to appoint a new supplier who, as SoLR, agrees to pay the customers an amount equal to the credit balances which they held with their previous supplier.

Ofgem's criteria for the assessment of LRSP claims

21. Ofgem has published criteria for the assessment of LRSP claims, as follows:

> *"Our methodology criteria for SoLR levy claims are as follows:*
>
> *• Additional: whether the costs claimed are additional to the costs to the SoLR of serving existing customers. In addition, we consider whether these costs would have been expected at the time of the SoLR's bid and whether any commitments were given in relation to these costs in their competitive SoLR bid. Although the SoLR is generally expected to know or predict the costs they will incur in serving a new customer base and take these into account in their competitive bid, there may be cases where this is not possible.*
>
> *• Directly incurred as part of the SoLR role: whether the costs were incurred as a result of taking on customers in an emergency situation as opposed to normal customer acquisition routes. It would not be appropriate for us to allow the SoLR to claim for costs they would have incurred through a normal acquisition route.*
>
> *• Otherwise unrecoverable: whether the SoLR could have recovered the costs through other means. It would not be appropriate for us to allow the SoLR to claim for costs it could have recovered through the administration process or customer charges, for example.*
>
> *• Unavoidable: whether the SoLR had made all reasonable efforts to avoid the cost in the first instance or absorb the cost.*
>
> *• Efficient: whether the SoLR has taken all reasonable steps to reduce the magnitude of any unavoidable and unrecoverable costs incurred, and therefore the total amount claimed."*

Factual Background

The failure of Extra Energy

22. In November 2018, the energy company, Extra Energy Supply Limited, informed Ofgem that it was in severe financial difficulties and would cease trading shortly. Extra Energy provided information to Ofgem that it was supplying electricity to 128,841 households and businesses and gas to 94,804 households and businesses.

The bidding process to become SoLR

23. Accordingly, on 21 November 2018, Ofgem approached ScottishPower and other energy companies requiring them to provide information to enable it to appoint a supplier to continue the supply of gas and electricity to the customers of Extra Energy (a request for information (RFI)).

24. Responses were required by 22 November 2018. Ofgem listed a series of questions to which it required answers. These included questions about the arrangements for migrating customers of Extra Energy onto the potential SoLR's relationship management and billing systems; ensuring adequate arrangements were in place to deal with queries without a deterioration in all customers' experiences; and how the potential SoLR would ensure that customers received a timely and accurate bill. The request provided summary information about Extra Energy's customers and included an Annex on "Frequently Asked Questions". The RFI said that it would give preference to appointing suppliers who agreed to honour credit balances. On Last Resort Supply Payments, Ofgem said:

> *"We will consider allowing access to the industry levy for a Last Resort Supply Payment to cover these costs of honouring domestic customer credit balances and other costs. Our preference is for Licensees to waive their right to the levy. Where a Licensee does not waive their right to the levy, we would consider any claim under the levy on a case by case basis, and decide whether any claim was justified taking into account all the circumstances of the case."*

25. Questions 23 and 24 posed the following questions*:*

> *"23. State if the Licensee agrees to waive its right to make a claim for a Last Resort Supply Payment before being appointed a SoLR.*
>
> *24. If not, please specify the basis on which the Licensee expects to make a claim for a Last Resort Supply Payment. This should specify what types of costs (or other areas as set out in the Relevant Licence Conditions), including but not limited to credit balances, the Payment would cover. Please specify the upper limit of any claim the Licensee would make for such a payment, or categories of costs to which the payment relates."*

26. More detail was provided in an Annex of FAQs.

> *"What costs are eligible to be reclaimed through the levy?*
>
> *The supply licences (SLC 9.3 and 9.4) provide that the SoLR would be able to make a claim to recover its reasonable incremental costs incurred in taking on the new customers where those costs are additional to the total amounts recovered from the customers for the supply where it has not waived its right to do so. This may include, if appropriate, certain costs of honouring credit balances for domestic customers.*
>
> *We expect any SoLR to factor in the costs it expects to incur in carrying out the SoLR based on the information provided into its proposals to the SoLR. We would consider and decide on a case by case basis whether the amount of any claim or the reasons for any claim were reasonable.*
>
> *…*
>
> *other things being equal, we will give preference to suppliers who will honour both open and closed credit balances, and those who will not make a claim for a LRSP or if they do intend to make a claim will minimise the expected size of that claim."*

27. The FAQs also addressed the question of transferring the direct debits of customers of Extra Energy to the potential SoLR:

> *"Can Direct Debits be automatically transferred to the new incoming supplier?*
>
> *Our view is that it would not be possible to transfer direct debits directly through the SoLR process. The SoLR could seek their own commercial arrangements alongside, but separate from, the SoLR process, with the current providers of direct debit management services to Extra Energy customers to help manage the transition to the new supplier."*

28. Eight energy companies, including ScottishPower, indicated a willingness to take on the SoLR role.

29. In making its bid, ScottishPower noted the potential difficulties with the transfer of customers. It acknowledged the uncertainty as to the quality of the relevant customer data and that "s*ome challenge may emerge through this process*" but considered that it had "*excellent relationships with all relevant industry parties*" and as such "*will work closely with those parties to mitigate risks and manage this process to ensure the best customer experience for Extra Energy customers*". It expected the process to be "*relatively quick*":

> *"ScottishPower's systems and processes have the capacity to register and manage the additional customers from Extra Energy… has all necessary industry processes and arrangements in place to manage additional customers across Great Britain and is able to maintain adequate and increased credit cover where required within reasonable timescales.*"

30. ScottishPower also set out its intended deemed contract prices which were lower than its standard variable tariff. It made clear in relation to the Last Resort Supply Payment (LRSP) that it would make a claim in respect of credit balances above £10m "*to cover balances and associated costs, for example working capital requirements.*" In response to Ofgem's request that an upper limit for any potential LRSP claim be set out, ScottishPower stated that it could not provide an upper limit on any LRSP it might make because "*we cannot at this point set out any additional areas where we can foresee us making a claim at this point. However, if ScottishPower is appointed and we are then exposed to additional costs which are unforeseeable and unexpected at this point based on the information we have been provided, we may make a further claim for a [LRSP]*"

The decision to appoint ScottishPower as SoLR

31. On 24 November 2018, Ofgem announced its decision to appoint ScottishPower as the SoLR. Ofgem's letter announcing the appointment stated that ScottishPower's "*offer…represented the best deal overall for both customers of Extra Energy and all energy consumers.*"

32. The letter went on to state that:

> *"The decision to appoint a SoLR involves Ofgem making a judgement taking into account the full range of criteria and all the information provided by suppliers. In total, we received eight submissions from suppliers, setting out the terms they would offer to customers if they were to be appointed as the SoLR. Below, we have set out the material factors on which we based our decision that Scottish Power's proposal was the best deal for customers."*

33. Ofgem noted specifically that:

> "*All of the suppliers who were willing to honour credit balances indicated their intention to use the levy to cover some or all the costs of honouring credit balances through the levy. Most suppliers intended to use the levy to cover all of the costs of honouring credit balances, with a minority offering to contribute to these costs. Scottish Power proposed to make a substantial contribution toward covering credit balances, thereby claiming the least through the levy overall and minimising costs to all consumers. The majority of suppliers stated their intention to use the levy to cover a range of additional costs they expected to incur if appointed as SoLR, other than the costs of honouring open credit balances. Scottish Power's bid identified the fewest costs in this regard, as compared to others'.*"

34. As regards tariffs, Ofgem noted that "*Scottish Power offered to move Extra Energy's domestic customers onto a tariff that was comparable to other bids received and cheaper than their standard variable tariff. Scottish Power's non-domestic tariff was cheaper than the majority of bids.*"

35. As regards on-boarding customers, a term used to describe the process of transferring customers from one supplier to another: "*[b]idders put forward a range of solutions to "onboard" Extra Energy's customers, and [Ofgem] closely assessed each of these. Scottish Power provided a strong bid that included assurances on getting in touch with customers in a timely way.*"

The difficulties faced by ScottishPower as SoLR in setting up new accounts and direct debits

36. Following its appointment as SoLR, ScottishPower began taking steps to set up new customer accounts and apply credits to those accounts. There were however significant

difficulties in doing so. ScottishPower explained the difficulties in evidence to the Court from its Operations Director. There were substantial problems in setting up direct debits for customers. Amongst other difficulties, PricewaterhouseCoopers, the administrators of Extra Energy, refused to allow the existing direct debits of its customers to be utilised by ScottishPower to collect payments from customers. ScottishPower had to contact customers to put fresh direct debit arrangements in place. It was however difficult to make contact as there were significant gaps in the email and telephone records provided by Extra Energy. By September 2019, ScottishPower had only been able to commence collecting direct debit payments from 56 per cent of the Extra Energy customer base, despite the fact that immediately prior to being appointed SoLR, 92 per cent of customers had been paying by direct debit.

37. ScottishPower also faced considerable difficulties in returning credit balances to customers. The necessary information about Extra Energy's customers was incomplete and not in a standardised format, forcing ScottishPower to seek information from other sources and to employ staff and third-party contractors to review the data and create accounts manually. Even once accounts had been opened, ScottishPower could not begin to bill customers until it knew the opening meter readings. Ordinarily the opening meter reading used by a new supplier would be received via a data "flow" from the previous supplier, as part of the industry process for change of suppliers. However, Extra Energy had lost the ability to initiate these types of data flows. ScottishPower had to work with PricewaterhouseCoopers and Extra Energy to set up a manual process of exchanging spreadsheets and agreeing the readings to be used for opening new accounts and closing the accounts with Extra Energy. A number of difficulties were experienced with this process. Consequently, ScottishPower did not start applying credits to the accounts of domestic customers until June 2019, twenty-nine weeks after its appointment as SoLR. This was far longer than the four-to-six weeks timescale it had anticipated. For non-domestic customers, ScottishPower was not able to start applying credits to their accounts until January 2020. The delays in returning credit balances not only caused an increase in customer queries and complaints, but also resulted in increased levels of customer debt. Affected customers were reluctant to pay ScottishPower monies for their new supplies, in circumstances where they believed they were still owed monies by Extra Energy in respect of their previous account balances.

38. ScottishPower's Operations Director explained in evidence that a prospective SoLR is heavily reliant on the information given by Ofgem as to the quality of the failing supplier's data because of the short time period in which a prospective SoLR is required to make a bid. ScottishPower only had two days to make its assessment. In contrast, Ofgem had greater contact with the failing supplier and, thus, greater insight into the quality of the data. Yet, Ofgem gave ScottishPower no reason to believe that it would encounter such a high level of missing or incomplete customer records.

39. Ofgem's position on the difficulties was explained in evidence from its Deputy Director of the Retail Directorate, with responsibility for issues relating to the energy retail market and suppliers. By May 2019, Ofgem was sufficiently concerned by ScottishPower's SoLR performance to decide to raise the matter at a meeting between Ofgem's Executive Director for Consumer and Markets and the Global Retail Director of Iberdrola, the parent company of Scottish Power. An internal briefing states:

> *"we are significantly concerned with their post-SoLR compliance performance with regards to former Extra Energy customers, and it would be helpful if you can impress upon them [ScottishPower] the urgency of this situation."*

40. The memo went on to state that:

> *"3. Our current concerns with the company – compliance/enforcement*
>
> *3.1… There has been a significant delay in PWC generating final bills for former Extra Energy customers, which is due to the poor data that they inherited from Extra Energy which has required significant work to remedy…*
>
> *3.2. SP did not agree to buy the debt book and have argued that they consider it is PWC's responsibility to sort out final bills. Whilst this is true to some extent, SP have a responsibility to the customers that they have inherited to ensure as smooth a transition to SP as possible, as well as to honour credit balances.*
>
> *PWC have requested ScottishPower to pay them for generating final bills for customers with credit balances, once they have resolved the data issues. ScottishPower are not happy about this, claiming this was a cost they hadn't considered in their SoLR bid, and are seeking reassurance that they can claim for this from the*

> *levy. Our view is that it will be very difficult to justify costs related to this in a levy claim as it is ScottishPower's responsibility as the appointed SoLR to ensure they do everything in their power to return credit balances to customers as soon as possible. We haven't experienced this issue to this extent with other SoLRs."*
>
> *Key messages:*
>
> *• This continued delay in issuing final bills and credit balances to former Extra Energy customers is not acceptable.*
> *• Whilst we appreciate that PWC is a crucial part of this process, SP has a duty to its customers to ensure a high-level of customer service and rapid issuance of credit refunds.*
> *• We urge SP to continue to do everything possible to resolve these issues ASAP."*

ScottishPower's claim for a Last Resort Supply Payment

41. On 29 October 2019, ScottishPower submitted a provisional LRSP claim for £18,938,589. It claimed for various heads of costs including:
    a) credit balances (for domestic and non-domestic customers) over and above the £10,000,000 it committed to in its SoLR bid (£8,656,024), associated customer service costs (£1,647,478) and billing costs (£753,984);
    b) additional costs incurred as a result of "*poor-quality data that impacts on ScottishPower's ability to register Extra Energy customers in a timely manner and to return credit balances as quickly as ScottishPower wished to do so*" (£313,156);
    c) additional costs in relation to difficulties with registering customers in ScottishPower's systems and for fixed gas transportation charges incurred during the period between transfer to ScottishPower as SoLR and registration of the customer account (£2,086,418) (ScottishPower subsequently withdrew this aspect of the claim);
    d) working Capital costs (£1,964,051);
    e) debt costs for the cost of money owed to ScottishPower in respect of energy supplied to former Extra Energy customers by ScottishPower after its appointment as SoLR (£3,517,478). It is this head of cost which forms the focus of the present claim.

42. The debt costs of £3,517,478 comprised £131,000 for debt follow up work, £536,000 for the cost of working capital associated with this debt, with the largest component for

customer debt provision (£2,850,000). ScottishPower structured its claim by reference to Ofgem's published criteria for the assessment of LRSP claims (i.e. whether the costs were additional; directly incurred; otherwise unrecoverable; unavoidable and efficient). In particular, ScottishPower explained it had not been able to recover the debt and considered it would not now do so. It compared the debt costs of new customers gained in November 2018 (a 'business as usual' scenario) with debt costs attributable to former Extra Energy customers, identifying the difference between the two as attributable to the SoLR process. The key causes of the debt were said to be the issues and delays experienced in returning customer credit balances occasioned by poor quality customer data from Extra Energy and the difficulties in setting up direct debits. Information provided by Ofgem had indicated that 92% of Extra Energy customers were on direct debits whereas ScottishPower had only managed to get 56% of customers onto direct debit by September 2019.

Ofgem's decision making process

43. In light of the nature of the claim advanced by ScottishPower, it is necessary to set out Ofgem's decision making process in some detail, by reference, in part, to internal documents disclosed in these proceedings.

Ofgem's initial internal views on the debt claim

44. An internal Ofgem memo, dated 25 November 2019, shows its initial considerations of debt costs:

> *"1.31. We need to look in more detail at the information supplied to ScottishPower to confirm its view that it suggested that 92% of customers were on the DD payment method. We also need to consider why the debt levels of the ex-Extra Energy customers are so high – to what degree is the level of debt a consequence of failure in the information provided as part of the SoLR process, or of the timescale and process for returning customer credits and /or collecting debt, and where does the responsibility for these factors lie? However, before those questions we need to ask whether the industry levy can be used to protect SoLR suppliers from debt accrued after the transfer of customers? (My view, no, it cannot)."*

Bilateral engagement between ScottishPower and Ofgem (early 2020)

45. On 18 December 2019, Ofgem wrote to ScottishPower to say that it had carried out an initial analysis of the LRSP claim and "*would find it really helpful to have a meeting in the New Year to discuss in more detail as there are several areas where we currently have questions or concerns*". That meeting took place on 16 January 2020 and constituted a "*high level review*" of the claim. Prior to the meeting, Ofgem prepared an internal memo highlighting the novel nature of elements of the claim:

> *"The claim contains some new elements which we have not seen before – for example customer debt and service/operational costs for credit balances. Therefore, this will take some time to consider and we may require additional information to understand more about the circumstances and rationale behind the individual figures."*
>
> *"This type of claim has not been seen before. There is a significant question over whether this type of cost is recoverable – i.e. protecting SoLR suppliers from debt accrued after the transfer of customers."*

46. The memo set out a list of questions to ask ScottishPower at the meeting, including:

> - "*In your view what level of debt is a consequence of failure in the information provided as part of the SoLR process, or of the timescale and process for returning customer credits and/or collecting debt?*
> - *What percentage of customers were paying by direct debit? (the 92% direct debit figure does not seem to have been quoted in the initial submission we sent)*
> - *How much of the 'debt' accrued after the transfer of customers to ScottishPower?"*

47. The minutes of the meeting on 16 January 2020 record discussion around the specifics of the customer transfer process. These included ScottishPower not getting bank details for each of Extra Energy's former customers automatically; assumptions by ScottishPower prior to its appointment as SoLR; and the difficulties faced by ScottishPower after its appointment in relation to transferring customers over to it.

48. After the meeting, there was an exchange of additional questions from Ofgem followed by a further meeting on 20 February 2020. The minutes of this meeting, prepared by Ofgem note the following:

> *"Considered Direct Debit assumptions – Assumed transitioning Direct Debits would be straight forward – but this did not occur due to data protection issues (e.g. bank details) and then rules that they had to ask customer for consent. As default customers were then transferred to quarterly not monthly payment plan, caused further issues.* Note: consider then the issue was assumption Direct Debit transfer was the root cause of issue (not realistic and not foresee the data protection/consent impact), rather than the percentage of customers on Direct Debit."

Ofgem's internal considerations (May - July 2020)

49. During May and June 2020, Ofgem engaged in further internal analysis of ScottishPower's claim. An internal memo produced in May 2020 indicates Ofgem's position on debt costs at this juncture:

> "*ScottishPower did not specifically indicate that they intended to claim for debt provision or associated costs, however ScottishPower did indicate that they may claim for unforeseeable and unexpected costs. It is considered that the industry levy is not a mechanism that should be used to recover customer debt to a SoLR supplier, irrespective as to how that debt has arisen. Costs reclaimed should be in relation to costs incurred as part of the transition period and it would be unreasonable and unexpected to consider that the industry levy would cover costs which were incurred significantly after the initial onboarding period. While it has been indicated that the increased debt level has been partly as a result of the lower than anticipated number of customers on direct debit mandates (than initially assumed), the information on the estimated percentage of customers paying by Direct Debit was not provided until after the SoLR bidding process was complete. Furthermore, it was reasonably foreseeable (and this seems to be a more significant factor) that ScottishPower would not be able to use the current licence and would require consent to use the Direct Debit details. As highlighted in earlier publications for SoLR events, as part of the SoLR process we revoke the existing licence and during the SoLR bid we ask what licence they would transfer customers too [sic] if they were actiing [sic] as SoLR. In addition, it is noted that circa half of the*

> *debt cost is associated with SME debt and it is difficult to see how it would be reasonably expected that the industry levy would cover costs for SME debt when SME credit balances are not covered. Businesses are expected to go through the administration process in the same way if any other service provider entered into insolvency proceedings."*

50. Also, in May, Ofgem analysed the debt costs against its published criteria and concluded that the debt costs did not satisfy the criteria. In summary, its reasoning was as follows in this respect:

    i) Debt provision: The costs were not additional on the basis it should have been reasonably foreseeable that the levy would not cover the debt costs after transfer. They were not directly incurred as part of the SoLR role. A significant proportion of the costs related to SME. They were otherwise recoverable. They were not unavoidable on the basis that ScottishPower could have done more to manage customers, as for example with more active contacting; earlier set up of payment plan; earlier gesture of goodwill or pay estimated credit balance. It was also reasonably foreseeable that debt may rise if payment terms were not set up/moved to quarterly billing. Finally, the costs incurred were not efficient on the basis they are considered disproportionate to costs to avoid in first place. (e.g. more active contact/set up to avoid build-up of debt/agree estimate credit balance).

    ii) Debt follow up: the costs were not additional, not unavoidable and not efficiently incurred, but were directly incurred as part of the SoLR role. They were otherwise recoverable.

    iii) Debt Working Capital: the costs were directly incurred as part of the SoLR role, but they were not additional, unavoidable and not efficiently incurred. They were otherwise recoverable.

51. Another internal document setting out Ofgem's overview of the wider claim underwent various drafts during May 2020. Ofgem's view at this stage on the various heads of claim was that the claim for credit balances, data quality costs and working capital were "*mostly uncontroversial*". It considered it may be able to consent to the category of customer service/operational costs and billing costs, "*even if we cannot consent to the full cost*

claimed (due to our view on where responsibility for the cost lies)". However, debt costs (as well as the costs of energy and transportation costs for customers who switched before ScottishPower could register them) "*are more challenging*". For these costs, ScottishPower has either failed to "*explicitly provide for them in the [Request for Information] or is claiming for costs that no SoLR has claimed to date (consumer debt) or that we have previously rejected (cost of energy and transportation).*" The view expressed on customer debt was as follows:

> *"Our view - debt*
>
> *1.42. We have not previously been asked to consent to the recovery of debt costs. To do so now would set a precedent that could have very significant consequences for the SoLR process. In particular, accepting that consumer debt could be recovered from the levy could reduce the incentive for future SoLR's to chase consumer debt – and if more widely known could impact on the behaviour of at least some consumers of failed supplier, making it more difficult for SoLR's to recover debt, thus creating an unvirtuous feedback loop into the process.*
>
> *1.43. Unless we wish to set a radical new precedent that risks increasing the costs passed to consumers, we need to reject the claim for debt costs. Whether it is entirely fair for the SoLR to cover the costs of debt where that debt is much higher than BAU levels, is another question."*

52. A further internal memo dated June 2020 records that:

> "*1.30. ScottishPower has claimed £3,517k for debt costs. This is made up of the elements shown below, for the cost of following up customer debt, for working capital used to finance the debt, and the customer debt itself.*
>
> *1.31. <u>In theory, the claim for debt appears to meet the tests that we would normally use to judge whether a cost is recoverable.</u>*
>
> - *The debt is an additional cost faced by ScottishPower that arose only in relation to customers taken on by ScottishPower acting in its role as a SoLR supplier.*
> - *ScottishPower say that they anticipated that debt would arise, as normal, and made a provision of £1.2m for debt, but the debt is £4m (hence the £2.8m claim for debt provision). Factors raised by ScottishPower include its expectation, based on information provided by us following its appointment, that 92% of customers*

> *were on DD payment method (the outturn position is 56% on DD). ScottishPower was unable to use customers prior DD mandates and this (ie they needed fresh consent), and this [sic], and issues with customer data and customer reluctance to pay bill[s] while credit balances were not confirmed, led to levels of debt [that] was substantially higher than anticipated/expected compared to the same number of customers acquired by normal acquisition routes.*
>
> - *While debt is in principle recoverable, there is a point in the debt recovery cycle where it is commercial practice to cease recovery efforts and either write the debt off / sell the debt book/ pass it to an agency for collection.*
>
> *1.32. Whether the level of customer debt was avoidable and whether ScottishPower has done all that it can to collect the outstanding debt and therefore minimise the claim, is a judgement call. However, it is arguable that it would be unreasonable and unacceptable to place the burden of customer debt on the industry levy, as this would make consumers responsible not just for the economic and efficient cost of the work necessary to on-board the customers of a failed supplier and refund credit balances a supplier failure, but also the cost of customer debt. The levy is not a mechanism that should be used to recover customer debt to a SoLR supplier, irrespective as to how that debt has come about."*
>
> (Emphasis added)

53. In submissions, ScottishPower pointed to the (underlined) text in §1.31 to submit that its claim satisfied Ofgem's methodological criteria. In response, Ofgem pointed to the (underlined) text in §1.32 and said its position was that the claim did not meet all the criteria.

54. An internal memo dated 6 July 2020 records Ofgem's analysis of ScottishPower's final claim, which had been submitted on 3 July 2020. Relevant extracts are as follows:

> *"1.21 We are uncomfortable with ScottishPower's claim for £3.5m for customer debt (and related costs). Customer debt is a commercial risk for any supplier. In this case debt costs for the ex-Extra Energy customers are higher than forecast by ScottishPower based on BAU metrics for its existing customer base.*

1.24. Consenting to this element of the claim, without ScottishPower having specified that they would seek to recover debt in the RFI, or in the absence of an agreement that it could be recovered, would set an unhelpful precedent that could expose the SoLR regime to the cost of unanticipated consumer debt. This could lessen the incentive for future SoLR's to collect debt.

1.25. Equally, a decision to rule out the recovery of debt may reduce the flexibility we have for future SoLR's. If general market conditions and concerns about the issue of customer debt (including the overhang of debt from a failed supplier) make suppliers less likely to volunteer for a SoLR role, we may end of having to instruct a supplier to act as a SoLR. Should we do so, customer debt is one of the costs that the levy would be required to consider (and perhaps we would need to provide some reassurance on this at the outset).

1.26. In the absence of perfect information, it is easier to reach a yes/no decision on the basis of a general principle, than to consider any point in between. If we wish to retain flexibility to consider debt as a recoverable cost for future SoLR's we could explore options based on a risk sharing arrangement for consumer debt. On that basis we might consider allowing ScottishPower to recover: [the memo goes onto set out various arithmetic risk sharing options including the cost of work to recover the debt; the cost of the debt and the collection costs or a portion of the debt costs.]

1.27. Of these options, 50:50 may be the sweet spot. It feels more robust to go with 50:50 on the basis that while ScottishPower made no explicit provision for the recovery of debt, and without seeking to pin down the responsibility for the extent of the debt, we are broadly sympathetic to the situation in which it found itself (and which other SoLRs could find themselves). This approach would allow ScottishPower to recover half of the debt and the costs of collection (£1.5m).

1.28. If we wish to we could also consider consenting to ScottishPower recovering the cost of working capital for the entire debt as part of the calculation of the cost of capital. This could lift the total recovery for debt related costs to midway between £1.5 and £2m (possibly closer to £2m).

*1.29. An **alternative approach** is to reject the claim for debt costs and only allow debt costs in future where a SoLR has expressly provided for them in the RFI or we have instructed a supplier to act as a SoLR. This would be justifiable on the basis that the supplier made provision for the debt or did not volunteer for the SoLR role. But if we restricted the recovery of debt to SoLRs we*

> *appointed then it could narrow the choices we may have between suppliers.*
>
> *1.30. I think we need to have a further discussion on this point, which has a significant impact on the amount we would be minded to consent to and would represent an important evolution in our approach to assessing LRSP claims."*

55. Ofgem had an internal meeting to discuss matters on 13 July 2020. Following the meeting an internal memo was produced setting out recommendations. The document sets the context (§1.2); explains that debt is a commercial risk for a supplier (§3.3); and that its decision is case specific (§3.4):

> *"1.2 ScottishPower's claim is the most complex we have seen so far. The background is as much a part of the story as the costs claimed: the circumstances of the SoLR incident; the quality of the SoLR data; the tension in the relationship between PwC (the administrators for Extra Energy) and ScottishPower, which appears to have driven by different viewpoints and competing objectives; and issues that ScottishPower did not anticipate before appointment.*
>
> *3.3 We are uncomfortable with ScottishPower's claim for £3.5m for customer debt (and related costs). Customer debt is a commercial risk for any supplier. In this case debt costs for the ex-Extra Energy customers are higher than forecast by ScottishPower based on BAU metrics for its existing customer base.*
>
> *3.4. On balance, we recommend that we do not consent to the recovery of any of the £3.5m claim for debt costs. Each levy decision is taken on a case-by-case basis, and we are confident that we could reject this element of the claim while retaining the flexibility to allow customer debt costs to be recovered in future. For example, we may be more receptive to a case where a SoLR has expressly provided for them in the RFI or where we have instructed a supplier to act as a SoLR."*

Ofgem's minded to position (August 2020)

56. Work started on the preparation of a draft letter setting out Ofgem's 'minded to' position and a further document containing a high-level summary of Ofgem's position on the costs it was not minded to consent to, including debt costs. Drafts disclosed in these proceedings show an internal comment on a version of the summary document which reads as follows, *"…trying to look for ways to be firm on this point while tying to the specific case to not preclude a SoLR from explicitly saying "I'm going to claim for bad debt for these customers in future*."

57. The final version of the summary document states as follows:

> *"ScottishPower's claim has presented us with a number of novel issues, and we have given considerable thought to these in reaching a minded-to position.*
>
> *In principle we are minded to consent to the recovery of the costs of credit balances and certain related costs, i.e. customer enquiries and direct complaints, billing, IT costs and for the costs of working capital associated with these costs.*
>
> *We are not minded to consent to the recovery of the costs of the Ombudsman Scheme, customer debt, or for transportation and registration services. The costs we are not minded to consent to represent around £5m of the claim and we appreciate that ScottishPower will be disappointed by our position.*
>
> *Our minded-to position aims to recognise the particular and challenging circumstances of this case, and balance this with the interests of consumers who ultimately fund the industry levy. We recognise that you may be disappointed and we would be happy to discuss our minded-to position.*
>
> *I have set out below a high-level summary of our position on those costs we are not minded to consent to."*

58. In respect of the consumer debt element of the claim, Ofgem gave its 'high level' reasoning as follows:

> *"Consumer debt*
>
> *The collection and recovery of customer energy debt is a commercial matter for suppliers to pursue. While the level of consumer debt may be higher than ScottishPower anticipated, we do not consider it would be appropriate for the industry levy to fund consumer energy debt. Consumer debt is distinct from credit*

> *balances and other costs associated with on boarding customers in order to comply with the terms of the Last Resort Supply Directive. It is in this cost, particularly, that we consider the LRSP claim to be broader in scope than the basis on which ScottishPower was appointed and different to the cost claimed for credit balances (and costs associated with credit balances and working capital), which is the basis on which ScottishPower was appointed."*

59. The summary document was sent to ScottishPower on 11 August 2020, with the offer of a follow up conversation to discuss further. The offer was accepted by ScottishPower on the basis that a meeting would enable it to "*go through each area in detail and understand more fully Ofgem's position*" as well as to "*share any further thoughts that we have on those areas Ofgem is minded not to accept at this point*'. Following a telephone call on 14 October 2020, a meeting took place on 9 November 2020. An internal Ofgem email sent the day before the telephone call indicates Ofgem proposed to tell ScottishPower it would "*...reflect on any evidence and let them [ScottishPower] know if we [Ofgem] have any further questions (or it changes our minds) but this is the current position of decision makers*."

60. ScottishPower presented slides at the 9 November meeting which addressed each of Ofgem's reasons for proposing to reject the claim for debt-costs. ScottishPower recorded its view of the 9 November meeting in an internal e-mail, stating that Ofgem:

> "*noted they would review the detail within the slides, noting that it was a helpful meeting and the points we shared were useful. [The Ofgem representative] noted that Ofgem had already considered our claim in a lot of detail, but they would consider the additional detail we provide and come back to us.*"

61. On 19 November 2020, Ofgem provided its response to the additional information from ScottishPower by email as follows:

> "*We note the points ScottishPower has made in the additional information and have considered them carefully. It is for the SoLR to make the claim and to provide the evidence to support the claim. In making a decision we do not consider, for example, that we are bound to consent to a cost if we did not previously*

> *exclude it from the type of costs that could be claimed. Equally, we do not consider that we are bound to consent to the recovery of all or part of the cost of bad debt (or any other cost), because, in the RFI, ScottishPower said it may make a claim 'if exposed to unexpected costs'. As we noted previously, we consider bad debt to be distinct from credit balances and associated costs. While we accepted that data quality issues were a factor in the cost of credit balances and associated costs, we do not consider that this restricts our discretion to reach a different position on the cost of bad debt. Each claim, and each part of a claim, is considered on its merit. In securing an outcome in the best interests of consumers we must have regard to the wider context of the SoLR regime and our assessment of claims from other SoLRs, in addition to reviewing the evidence against the criteria in our methodology."*

62. ScottishPower responded to Ofgem's email, withdrawing its claim for transportation and registration costs and domestic ombudsman costs, but continuing to maintain the debt claim, albeit reducing it by £453,000, to £3,062,000.

Industry Consultation on Ofgem's minded to position (December 2020)

63. Ofgem consulted industry on its 'minded to' position on ScottishPower's claim. The consultation was addressed to "*Gas and Electricity Suppliers, Electricity Distribution Network Operators, Gas Transporters and all other interested parties*" on the basis these parties were directly affected by a claim on the industry levy.

64. On 3 December 2020, Ofgem emailed ScottishPower a pre-publication copy of the consultation. ScottishPower responded on the same day with comments.

65. On 7 December 2020, Ofgem issued the consultation. The consultation document explained Ofgem's general approach to LRSP claims and attached its methodology criteria as Annex I to the document explaining their status as follows:

> *"Our decision process and methodology*
>
> *Our process to reach our minded-to position consisted of:*
>
> *• A quantitative check of the methodology for each cost item claimed. This includes determining how each total cost item was calculated based on data sent to us.*

> • *Ensuring costs are in line with commitments made at the time of the SoLR appointment.*
>
> • *Validation of assumptions with other data sources, where appropriate.*
>
> • A qualitative assessment of each claim item against our methodology criteria.
>
> *Our methodology is outlined in Annex 1."*
>
> (Emphasis added)

66. The letter went on to explain that Ofgem proposed to grant ScottishPower £10.6m of its £13.6m claim *"in light of the broader market considerations and our wider statutory duties to protect both existing and future consumers."* Each head of claim was set out together with Ofgem's position. On debt costs, Ofgem explained that:

> *"We consider that consumer debt is different to credit balances and other costs faced by a SoLR when on-boarding customers and is a commercial matter for the SoLR to manage*
>
> ...
>
> *We consider that a claim for consumer debt goes beyond the reasonable scope of the basis on which ScottishPower was appointed and the costs that it indicated it may claim. Consumer debt is a commercial consideration and we would expect a supplier bidding for a SoLR appointment to have accounted for this in the bid, along with other commercial factors such as forecasts for margins and retention of customers*
>
> *…*
>
> *in our view consenting to a claim for debt costs could increase the potential costs of supplier failure faced by existing and future consumers if it lessens the incentive on a SoLR to collect debt effectively, in the knowledge that debt that could not be collected could be recovered as part of a LRSP claim*
>
> *…*
>
> *We welcome responses from stakeholders on whether our position strikes an effective balance between providing an appropriate framework for SoLR's to recover additional costs and protecting the interests of existing and future energy consumers."*

67. ScottishPower responded to the consultation on 13 January 2021 explaining its opposition. There was one other consultation response, agreeing with Ofgem that ScottishPower should not recover debt costs. Ofgem put the response to ScottishPower for its views and ScottishPower responded on 20 January 2021. A copy of the pre-publication draft of Ofgem's final decision was shared with ScottishPower on 27 January 2021.

Ofgem's final decision (January 2021)

68. The final decision letter, dated 29 January 2021, starts by confirming that Ofgem consents to ScottishPower claiming a LRSP of up to £10.6m, to recover the costs of protecting the credit balances owed to former customers of Extra Energy, and certain other costs. Ofgem explains that in taking its decision, it had had due regard to its

> "*principal objective of protecting the interests of current and future energy consumers, the relevant provisions of ScottishPower's gas and electricity supply licences, Ofgem's "Guidance on supplier of last resort and energy supply company administration orders" (our 'Guidance'), the terms of the LRSD and the particular circumstances of compliance with the LRSD."*

69. The letter set out the general background to the claim, of which salient parts read as follows:

> *"Claim for a Last Resort Supply Payment*
>
> *As set out in the gas and electricity supply standard licence conditions, a supplier may make a claim for any additional costs it incurs in complying with a LRSD. As part of their competitive bid to become a SoLR, a supplier will include whether they expect to make a claim for a LRSP, or whether it will waive this right, in whole or in part. As stated in our Guidance, our preference is for the SoLR not to make any claim, and we expect efficient SoLRs to be able to minimise their exposure to otherwise unrecoverable costs to reduce the costs smeared across the rest of the market through a LRSP. In our Guidance, we explain that we will decide on a case-by-case basis whether it might be appropriate for a SoLR to make a claim under these arrangements. We also explain that we would consider whether the amount of any claim or the reasons for any claim were reasonable. In that Guidance, we note that, in certain circumstances, we may consider it appropriate to approve a*

> *claim where it relates to costs associated with the protection of customers who held a credit balance with the failed supplier.*
>
> *ScottishPower indicated at the time of our SoLR appointment process that it would not waive its right to make a claim. ScottishPower committed to funding £10m of open and closed credit balances and said that it would claim for any balances above this £10m level and associated costs, for example to cover working capital requirements."*

70. The letter then turns to Ofgem's reasons for its decision. Relevant extracts are as follows:

> *"Our decision*
>
> *On balance, taking into consideration all information available to us and the specific circumstances of this case, we are minded to consent to ScottishPower claiming a LRSP of up to £10.6m. We have taken this decision in light of the broader market considerations and our wider statutory duties to protect both existing and future consumers.*
>
> *…*
>
> *For the avoidance of any doubt, we consider on a case-by-case basis whether it may be appropriate for any SoLR to make a claim for a LRSP. We have set out below our reasons for our decision. This should not be taken as setting a precedent for any future claims, which would also be considered on their merits and on a case-by-case basis, taking into account all relevant circumstances of the particular case."*
>
> (Emphasis added)

71. On credit balances (£6,526,000) the letter stated that Ofgem was satisfied *"that the claimed amount is consistent with the relevant criteria and, in particular, is consistent with the commitments made by ScottishPower in its SoLR bid."*. On the claim for customer service/billing costs in respect of the on-boarding of former customers of Extra Energy, the letter noted the view expressed in the industry consultation that the amount claimed for billing was excessive, before explaining its reasons for allowing this aspect of the claim:

> *"We have sympathy for the respondent's concerns about the level of operational costs claimed by ScottishPower.*

> *…*
>
> *However, after very careful consideration of the circumstances of this case and all of the information available to us, and on a fine balance, our decision is to consent to the recovery of ScottishPower's claim for service/operational costs.*
>
> *…*
>
> *ScottishPower incurred unforeseen costs when billing customers – for example those with credit or debit balances less than £30. Due to the circumstances of the failure of Extra Energy, ScottishPower did not have direct access to Extra Energy's billing platform and relied upon the arrangements put in place by the administrator with a third-party billing provider. As a result the billing costs were in excess of those usually incurred by suppliers when issuing monthly or quarterly bills.*
>
> *While we consider that the billing costs are high, our decision on balance to consent to the recovery of the service/operational costs claimed by ScottishPower reflects the volume of the work necessary to on-board customers, the data quality and other significant issues which ScottishPower encountered."*

72. Ofgem also allowed the claim for £313,000 for costs incurred in relation to data quality (i.e. IT work, managing and resolving issues relating to incorrect meter reads, account set-up issues, erroneous transfer issues, billing, meter reading, and complaints). It did so on the basis that:

> *"We recognise that a SoLR supplier can face differing levels of challenge with data quality. We consider that the work undertaken by ScottishPower was required to ensure that the data for former customers of Extra Energy was both complete and accurate, a necessary condition for the successful on-boarding of customers and resolution of customer enquiries. Our decision is, therefore, to consent to the recovery of this cost."*

73. It did not, however, allow the claim for £3.1m to cover the debt cost explaining:

> *"Stakeholder views*
>
> *One respondent agreed with Ofgem's minded-to position on consumer debt. The respondent considers that a claim for additional bad debt goes beyond the reasonable scope of a LRSP*

claim and any additional bad debt costs should be factored into a supplier's SoLR bid.

In making its claim for these costs, ScottishPower has noted it considers that consumer debt is no different from other costs incurred by a SoLR and considers that Ofgem's position on debt is inconsistent with its minded-to position to consent to the other costs which ScottishPower has claimed. They have also noted that, in bidding for the SoLR appointment, ScottishPower did not place a limit on the value of the claim it would make and said that it may make a claim for any unexpected costs. ScottishPower considers that the claim for debt is consistent with the criteria that Ofgem uses to assess claims.

ScottishPower have suggested that, if Ofgem's decision is that it is unlikely to allow a LRSP claim for debt costs, future SoLRs will be incentivised to "price in" an additional margin of error for bad debt (to cover unforeseen circumstances). They consider that this would result in worse outcomes for consumers (by suppliers potentially bidding with higher rates in respect of all SoLR appointments), rather than allowing a mechanism by which unforeseeable debt can be recovered from the industry levy in appropriate cases, thus avoiding the need for it to be priced in to the bids made by SoLRs.

Our decision

We consider that consumer debt is different to the other costs that ScottishPower has claimed which are directly related to the obligation to refund customer credit balances and to the work necessary to validate and migrate customer data from Extra Energy to ScottishPower's system, to allow ScottishPower to comply with the terms of the LRSD.

We recognise that ScottishPower did not place a limit on the value of the claim that it reserved the right to make, and indicated that it may make a claim for any unexpected costs. However, we continue to consider that the claim for consumer debt is outside the reasonable scope of the basis on which ScottishPower was appointed as the SoLR and the reasonable scope of any LRSP claim. While we do not set out in advance the costs that a SoLR may or may not claim, as noted above, our expectation is that a claim will be principally for the cost of credit balances and costs associated with migrating customers from the failed supplier to the SoLR.

In making a decision, we are able to have regard to a wide range of factors, including (for example) our view of whether it is reasonable that the wider industry should fund the commercial risks associated with the cost of debt. Taking account of all of the

> *circumstances of the case and having regard to our duty to protect the interests of consumers, we do not consider that the claim for debt is a reasonable cost to be recovered via the industry levy. While we are open to a range of costs forming part of a claim for a LRSP, we consider that a decision not to consent to the recovery of consumer debt sets the most appropriate balance between the ability of a SoLR to recover legitimate and efficient costs and protecting the interests of consumers. We do not consider that our approach should lead to potentially worse outcomes for consumers (i.e. suppliers potentially bidding with higher tariffs being charged to consumers in respect of all SoLR appointments), and note that only a single respondent has raised this as a concern.*
>
> *Nor do we consider our decision on the claim for debt to be inconsistent with our decision on the claim for the other costs claimed by ScottishPower. Our decision to consent to the recovery of service/operational and data quality costs is finely balanced and we do not consider that a decision to consent to some of the costs in the claim means that we are bound to consent to all of the costs claimed by ScottishPower.*
>
> *For the above reasons our decision is that we do not consent to the recovery of ScottishPower's claim for the recovery of consumer debt."*

Ground 1 – Ofgem fettered its broad discretion by taking an "in-principle" decision that debt costs were not within the scope of a LRSP. It therefore "closed its mind" to allowing this aspect of the claim. Alternatively, Ofgem did not explain to ScottishPower that it had a specific policy in respect of debt costs, which was not referred to in its published criteria for assessment of LRSP claims, which rendered the decision procedurally unfair.

ScottishPower submissions

74. ScottishPower submits that Ofgem has a broad discretion when considering whether to allow an LRSP. Ofgem has published criteria which constitute Ofgem's policy governing how it will exercise its discretion on a case-by-case basis. If the criteria are met then the LRSP claim will be allowed. Ofgem's decision in this case was unlawful because it took an in-principle decision that debt costs could not form part of an LRSP. It thereby fettered its broad discretion, disabling itself from giving proper consideration to its exercise. This

is apparent both from the content of the decision itself, in particular the reference to "*consumer debt is outside…the reasonable scope of any LRSP claim"* and from Ofgem's internal consideration of the claim. Ofgem never reached a firm final conclusion on whether the claim met its own criteria. There is no indication that the detail underlying ScottishPower's claim was considered and/or scrutinised by Ofgem. The clear picture which emerges is that Ofgem decided not to apply its criteria and instead took a decision that debt costs could not form part of a LRSP. In doing so, it "shut its ears" to the claim and disabled itself from giving it proper consideration. Further or alternatively, Ofgem did not disclose a specific, unpublished, additional policy in respect of debt costs, namely that debt costs would ordinarily not be allowed unless identified as a possible component of a claim when a SoLR was seeking to be appointed. This alternative policy could not have been apparent to ScottishPower. Had Scottish Power been aware of it, it could have addressed it.

Discussion

Relevant legal principles

75. It was common ground that a public authority vested with a discretionary power must not operate it in an overly-rigid manner, so as automatically to determine the outcome of its exercise. In British Oxygen Co Ltd v Minister of Technology [1971] AC 610, Lord Reid explained the general rule that a decision-maker must not "*shut his ears to an application*." However, there is nothing objectionable about a public authority establishing a principle, policy or rule for the exercise of a discretionary power. Policies are a necessary part of administrative functions. They are necessary both for the administrator, so as to ensure consistency and prevent arbitrariness, and for an individual affected by the decision making, so as to ensure legal certainty and predictability. Applied to the present context it means that an energy supplier bidding to become a SoLR knows from Ofgem's guidance that the regulator's general preference is for a SoLR not to make a LRSP claim and that suppliers will be expected to honour credit balances. This knowledge assists a supplier in assessing cost risks and benefits when bidding to become a SoLR. Accordingly, the existence of a rule, policy or principle governing the exercise of the discretion is not, of itself, a fetter on a discretion. A fetter arises only when the decision maker does not allow for the possibility of any exception to that rule, policy or principle. Thus, the decision maker

must *"always be willing to listen to anyone with something new to say"* (British Oxygen at 625A-F). In order to succeed on this ground, it is therefore necessary for Scottish Power to show that Ofgem "*shut its ears*" to considering ScottishPower's claim for debt costs.

76. It was also common ground that a person must know what the relevant policy of a public authority entails and must be able to make submissions about its application to their individual case (Lumba v Secretary of State for the Home Department [2012] 1 AC 245 per Lord Dyson at [34]-[38]).

Application of the legal principles to the evidence

77. It was common ground by the hearing, if not before, that ScottishPower's claim for debt costs was novel. No other SoLR had made such a claim. For this simple reason, Ofgem had no policy or principle on these types of claims at the point at which ScottishPower made its application.

78. On receipt of ScottishPower's claim, Ofgem began a process of consideration and analysis. It posed a series of questions seeking to understand why the debt levels of former Extra Energy customers were so high. It recognised it needed to look in more detail at the information it had supplied to ScottishPower (internal memo, dated 25 May 2019 at §44 above). Ofgem sought a meeting with ScottishPower in January 2020, to gather information about the claim. The minutes of that meeting record discussion of the circumstances which led to the accrual of debt by Extra Energy customers. A further meeting took place the following month. In between these meetings, Ofgem raised further questions of ScottishPower in writing (§45-48 above).

79. Between May – July 2020, Ofgem engaged in a process of internal deliberation. It analysed the claim against its published criteria. Its internal analysis comprised an intermingled assessment of the specifics of ScottishPower's claim with broader policy considerations (memo of June 2020 at §52 above). By July 2020, Ofgem had come to the view that it was uncomfortable with the claim. This was both for reasons specific to ScottishPower, because there had been no indication that it would seek to claim for debt in its bid, alongside broader policy concerns, that debt should be a commercial risk for a supplier. Nonetheless, Ofgem was concerned not to create an inflexible rule. An internal memo of 6 July 2020 records a

comment that "*a decision to rule out the recovery of debt may reduce the flexibility we have for future SoLR's"* and the note went so far as to consider the circumstances in which Ofgem might want to allow recovery for debt in the future (§54 above). The memo canvasses a number of options to resolve ScottishPower's claim, in part by reference to the specifics of ScottishPower's situation *("while ScottishPower made no explicit provision for the recovery of debt….we are broadly sympathetic to the situation it found itself in"*); and partly by reference to policy considerations. Ofgem considered further discussion was necessary given the significance of the issue to both ScottishPower's claim and the fact it would represent "*an important evolution in our approach to assessing LRSP claims"* (§54 above).

80. Further evidence that Ofgem did not want to create an inflexible rule is apparent from an internal draft of the summary document explaining its decision not to consent to the claim. It includes a comment which refers to the author "*trying to look for ways to be firm on this point while tying to the specific case to not preclude a SoLR from explicitly saying "I'm going to claim for bad debt for customers in future"" (*§56 above).

81. Ofgem continued to reflect on its emerging policy position and the specifics of ScottishPower's situation. It met again with ScottishPower in October and November 2020 and was willing to receive any further evidence from the company (internal Ofgem emails sent before the October meeting indicate Ofgem proposed to reflect on any further evidence from ScottishPower *"and let them [ScottishPower] know if we [Ofgem] have any further questions (or it changes our minds)"* §59 above). ScottishPower acknowledged Ofgem's willingness in this respect (internal ScottishPower email refers to Ofgem "*noted they would review the detail within the slides, noting that it was a helpful meeting and the points we shared were useful. She [i.e. me] noted that Ofgem had already considered our claim in a lot of detail, but they would consider the additional detail we provide and come back to us.*" § 60 above).

82. In addition, Ofgem consulted on ScottishPower's claim and its proposed response. In evidence to the Court, Ofgem's Deputy Director explained the purpose of consultation as being to "*improve...the quality of our decisions, facilitates industry planning and prioritisation, builds understanding of our work and enables progression towards consensual solutions that protect the interests of existing and future consumers*".

83. Ofgem's final decision was to refuse the debt claim. It did so for a mix of regulatory policy reasons on debt claims and reasons specific to ScottishPower. It is apparent from Ofgem's decision to allow ScottishPower to claim for costs arising from poor data quality and customer service/billing costs that Ofgem accepted ScottishPower's case that it faced significant difficulties in its role as SoLR (§71 & §72 above). Nonetheless, Ofgem took the view that debt costs were less directly related to the costs of onboarding customers. It had regulatory policy reasons for doing so, taking the view that a decision to refuse the debt claim represented '*the most appropriate balance between the ability of a SoLR to recover legitimate and efficient costs and protecting the interests of consumers'* (§73 above). Crucially, whilst expressing a policy position that debt claims were outside the scope of an LRSP claim, the decision letter did not preclude future consideration of debt claims by other suppliers:

> *"For the avoidance of any doubt, we consider on a case-by-case basis whether it may be appropriate for any SoLR to make a claim for a LRSP. We have set out below our reasons for our decision. This should not be taken as setting a precedent for any future claims, which would also be considered on their merits and on a case-by-case basis, taking into account all relevant circumstances of the particular case."*
>
> …
>
> *While we are open to a range of costs forming part of a claim for a LRSP, we consider that a decision not to consent to the recovery of consumer debt sets the most appropriate balance between the ability of a SoLR to recover legitimate and efficient costs and protecting the interests of consumers."*
>
> (Emphasis added).

84. Accordingly, drawing the analysis together, a review of Ofgem's decision making process demonstrates the following:

a) Ofgem had not seen an LRSP claim for customer debt before. ScottishPower's claim was novel in this respect. For this simple reason, there was no policy in place in relation to debt when ScottishPower made its claim in this regard.

b) Ofgem gave detailed consideration to the specifics of ScottishPower's claim, asking questions and gathering information about the difficulties faced by the company in 'on boarding' former Extra Energy customers. It liaised extensively with ScottishPower. In

the words of Lord Reid in British Oxygen, Ofgem was more than willing to listen to ScottishPower.

c) Ofgem applied its published criteria for assessing LRSP claims to ScottishPower's claim and decided that the debt claim met some but not all the criteria.

d) Ofgem moved through an analysis of the facts of the claim and consideration of its statutory duties, towards reaching a regulatory policy view that debt incurred by customers after the SoLR starts supplying them was different to other SoLR costs and should ordinarily be a commercial matter for a SoLR, not a cost to be borne by the industry levy. Ofgem was, however, explicit that its policy view in this regard did not preclude a case by case assessment of claims and its decision on ScottishPower's claim should not be taken as setting a precedent.

e) In so far as ScottishPower's application for debt costs led Ofgem to formulate an approach to such claims, ScottishPower played a formative role in Ofgem reaching that view, in which it was consulted both individually prior to the 'minded to' decision and as part of the consultation process that Ofgem carried out in relation to that 'minded to' decision.

85. ScottishPower's submission that an LRSP claim should be allowed if it meets Ofgem's published criteria for assessing LRSP claims ascribes too great a status to the criteria in the decision-making process and is, moreover, inconsistent with the regulatory scheme. The criteria were not referred to in Ofgem's Guidance on supplier of last resort. Similarly, they were not referred to in the November 2018 Request For Information from potential SoLRs or the accompanying FAQs, although ScottishPower explained in evidence to the Court that it was told orally by Ofgem to base its LRSP claim on the criteria and duly did so. Ofgem annexed them to its consultation and explained their role in its decision making (§65 above). As is apparent from the consultation document letter and the wording of the criteria themselves, they were used by Ofgem as part of its assessment process but not as an empirical, complete or exclusive tool in its assessment. They provided essentially subjective heads of assessment that Ofgem considered as part of a wider overall analysis of the merits of the claim. Used in this way, as Ofgem did, they are consistent with the regulatory framework which permits Ofgem a broad discretion in deciding on an LRSP claim, to be exercised on a case by case basis in accordance with Ofgem's principle objective to protect the interests of existing and future consumers (Condition 9.5 of the SLCs and s. 4AA Gas Act 1986 and s. 3A Electricity Act 1989). ScottishPower's

submissions amount, in effect, to a claim that a SoLR has a right or entitlement to an LRSP if it can establish that those heads of assessment are somehow met. Yet this amounts to a legitimate expectation claim which ScottishPower has rightly not advanced.

86. ScottishPower's criticism that Ofgem never reached a 'firm final conclusion' on whether the debt claim satisfied its criteria is rejected by Ofgem who explained in its evidence to the Court that it came to the view that the claim did not meet all the criteria. ScottishPower did not apply to cross examine Ofgem's witness in this regard and no allegation of bad faith has been raised. I accept Ofgem's position. I do not see how the timing of Ofgem's application of the criteria (May/June 2020) assists ScottishPower's case. The decision making spanned a period of 15 months. Ofgem considered the criteria in May/June 2020 and arrived at a provisional view in July 2020 that it was uncomfortable with the claim.

87. The submission that Ofgem did not grapple with the detailed evidence put forward by ScottishPower ignores the realities of the decision-making process, in particular the significant engagement and bilateral exchanges between Ofgem and ScottishPower during the course of the decision making. The statement relied on by ScottishPower in the final decision letter that *"a claim for consumer debt…is outside the reasonable scope of <u>any</u> LRSP claim*" must be read in context. Other parts of the letter explain that Ofgem's decision was taken on the basis of "*taking into consideration all information available to us and the specific circumstances of this case,"* and should not *"be taken as setting a precedent for any future claims, which would also be considered on their merits and on a case-by-case basis, taking into account all relevant circumstances of the particular case."*

88. ScottishPower's alternative submission, that Ofgem did not reveal or explain its specific policy that debt costs would not ordinarily be allowed unless identified as a possible component of a claim when a SoLR was seeking to be appointed, fails for the same reasons. There was no policy to this effect. In its assessment of the specifics of ScottishPower's claim, Ofgem was influenced by the fact that ScottishPower had not indicated its intention to make such a claim in its bid *("…we continue to consider that the claim for consumer debt is outside the reasonable scope of the basis on which ScottishPower was appointed as the SoLR"* §73 above*)* but its position in this regard was case-specific (*"Each levy decision is taken on a case-by-case basis, and we are confident that we could reject this element of the claim while retaining the flexibility to allow*

customer debt costs to be recovered in future. For example, we may be more receptive to a case where a SoLR has expressly provided for them in the RFI…." §55 above). The case of R (Lumba) v Secretary of State for the Home Department [2012] 1 AC 245, upon which the Claimant relies, is authority for the proposition that any guidance which sets out how decision-makers should exercise their discretionary powers must be published and that individuals subject to the policy have the right to know what a policy is so that they can make representations in relation to it. The facts of this claim are far removed from that proposition and the facts of that case.

89. Ground 1 fails.

Ground 2: The decision was irrational. Ofgem failed to follow its published criteria for assessing claims. In addition, Ofgem rejected the claim on nonsensical grounds, namely that debt costs fell outside the basis on which ScottishPower was appointed as SoLR; they were a category of costs which a SoLR should not be able to recover; and it was necessary to rule out the recovery of debt costs, as a matter of principle, in order to protect the interests of consumers.

ScottishPower submissions

90. ScottishPower submits that Ofgem's decision is outside the range of reasonable decisions open to it and there are demonstrable flaws in its reasoning. In particular;

a) Ofgem failed to follow its published criteria in taking the decision. Its final position on the criteria appears to have been that its debt claim probably satisfied them (the June 2020 internal memo).
b) In so far as Ofgem found that its criteria were not satisfied then its view in this regard was irrational.
c) There was no valid basis for Ofgem's reasoning that debt costs fell outside the scope of ScottishPower's appointment, given a key purpose of an LRSP is to allow recovery for unforeseen costs and the company had indicated it would claim for unexpected costs.
d) Ofgem's view that it was unreasonable for industry to fund the 'commercial risks' associated with the cost of debt applies equally to the costs associated with returning customer credits, data quality issues and customer service problems, which Ofgem was prepared to allow.

e) Ofgem took into account an irrelevant consideration, namely that it was necessary to rule out debt costs, as a matter of principle to protect the interests of consumers. The criterion that costs must be incurred 'efficiently' already provides appropriate protection in this regard.

Discussion

The legal framework for review

91. The legal basis for a challenge on the basis of irrationality, or as it is more accurately described, 'unreasonableness', has two aspects. The first is concerned with whether the decision under review is capable of being justified, or whether, put simply, it is outside the range of reasonable decisions open to the decision maker. The second aspect is concerned with the process by which the decision was reached. A decision may be challenged on the basis that there is a demonstrable flaw in the reasoning which led to it; for example that significant reliance was placed on an irrelevant consideration or that there was no evidence to support an important step in the reasoning or that the reasoning involved a serious logical or methodological error (Secretary of State for Work and Pensions v Johnson [2020] EWCA Civ 778.). ScottishPower relies on both aspects to advance its challenge under this ground.

92. Ofgem submitted that the Court should apply a wide margin of appreciation to its decision making given its role as a specialist regulator concerned with the operation of a market with predictions as to the future. It relied on the decision in R v Director General of Telecommunications ex p Cellcom [1999] ECC 314 at §26. ScottishPower submitted that the appropriate standard of review is the conventional *Wednesbury* standard. The evidence before the Court does not show that Ofgem engaged in complex, technical considerations.

93. I accept Ofgem's submissions as to the standard of review. There are parallels between the regulation of telecommunications by the Director of Telecommunications in ex parte Cellcom and the regulation of the gas/electricity markets by Ofgem in this case. In both cases, the decision making under challenge takes place in the context of the operation of a competitive market; the award of licences to operators and the power of the regulator to modify licence conditions. The key passage in Cellcom which Ofgem relies on is §26:

> *"Where the Act has conferred the decision-making function on the Director, it is for him, and him alone, to consider the economic arguments, weigh the compelling considerations and arrive at a judgment… so long as he directs himself correctly in law, his decision can only be challenged on Wednesbury grounds. The court must be astute to avoid the danger of substituting its views for the decision-maker and of contradicting (as in this case) a conscientious decision-maker acting in good faith with knowledge of all the facts… If (as I have stated) the court should be very slow to impugn decisions of fact made by an expert and experienced decision-maker, it must surely be even slower to impugn his educated prophesies and predictions for the future."*

94. Ofgem also pointed to the analysis in another case involving Ofgem; *Npower Direct Ltd and other companies v Gas and Electricity Markets Authority (Competition and Markets Authority intervening)* [2018] EWHC 3576 (Admin)) §§131-132 where the Court noted, albeit in the context of a proportionality challenge, that in assessing the adequacy of a regulator's analysis, a court should read that analysis generously and not every perceived deficiency in that analysis requires or permits that the measure be quashed: there is a question of materiality.

95. In this case, Ofgem has a statutory duty to protect the interests of consumers in the context of the failure of a supplier in a competitive market for services generally regarded as essential, by ensuring continuity of supply to customers of the failed company and to minimise wider negative impacts on the market. In witness evidence, the Deputy Director of the Retail Directorate of Ofgem explained the nature of the decision making in this case.

> *"In deciding what is reasonable in terms of any LRSP claim made, Ofgem needs to take into account the overall circumstances for current and future customers, as well as how suppliers will behave in subsequent bidding processes. As to the latter, Ofgem needs to take care not to create a situation where suppliers under-bid, whether intentionally or through inadvertence, being appointed as SoLR believing that they will then be able to claim against the industry levy. If Ofgem were to agree to any cost that arose directly from a supplier being appointed as the SoLR (whether foreseeable or unforeseeable) that would potentially create disincentives to act efficiently and incentives to under-bid or bid on the basis that a full safety net existed (i.e., without regard to commercial risk). Accordingly,*

> *where a supplier either (a) makes assumptions when bidding to be appointed SoLR in terms of estimating their cost-risks, which turn out to have been unwarranted; or (b) is faced with costs that it did not or could not have foreseen, it does not follow that it would necessarily be reasonable for Ofgem to agree to the LRSP claim or any specific part of it. Ofgem must look at the matter in the round, having regard to all the circumstances, including for example the risk of increased costs falling on consumers and the likely future conduct of energy suppliers."*
>
> *"In the course of making the Decision, I considered a wide range of factors, including (for example) my view of whether it was reasonable that the wider industry (essentially consumers) should fund the commercial risks associated with the cost of debt. Taking account of all the circumstances of the case and having regard to Ofgem's duty to protect the interests of consumers, I did not consider that SP's claim for debt was a reasonable cost to be recovered through an LRSP claim."*

96. This reasoning formed the basis for Ofgem's final decision ("*While we are open to a range of costs forming part of a claim for a LRSP, we consider that a decision not to consent to the recovery of consumer debt sets the most appropriate balance between the ability of a SoLR to recover legitimate and efficient costs and protecting the interests of consumers"* §73 above).

97. In my judgment Ofgem's decision making falls squarely within the scope of decision making at play in ex parte Cellcom and ought to be granted a margin of appreciation by the Court. There are parallels between the witness evidence of Ofgem's deputy director set out above, with the Court's observation in Cellcom that "*the Director (assisted by his expert staff) made his decisions… after a prolonged consultation period in the light of "his experience of monitoring and regulating the mobile telephony market over a long period."* (§26). Ofgem must make complex regulatory choices about the allocation of risks and costs in the event that a supplier has failed and must do so having regard to the future operation of the market, including the future role of a Supplier of Last Resort within the market and the potentially distorting effects of allowing a supplier to claim for customer debt accrued after customers have transferred to the SoLR. It is a decision that affects the entire industry and the operation of the market in the future. In particular, Ofgem must balance the need to ensure that its approach to claims for a LRSP ensures that suppliers are not disincentivised from bidding to become SoLRs, whilst not creating a moral hazard, namely,

circumstances where suppliers under-bid or take excessive risks bidding, knowing that any losses subsequently incurred could be recovered by way of a LRSP. This is a complex balancing assessment carried out by Ofgem as regulator, having regard to its principal objective to protect consumers.

Application of the framework to the evidence

98. Viewed in this context, ScottishPower submissions on this ground amount, in my judgment, to an impermissible attempt to re-argue the merits of the decision. In simple terms, Ofgem reached a judgment distinguishing between debt costs which are to be viewed as a matter of commercial risk for suppliers and other costs more directly associated with onboarding customers. It did so on the basis that this represents the most appropriate balance between the ability of a SoLR to recover legitimate and efficient costs and the need to protect the interests of consumers. Contrary to ScottishPower's submissions, Ofgem did apply its published criteria to the claim and reached the view that not all the criteria were satisfied. ScottishPower's challenge to Ofgem's view that the criteria were not satisfied amounts to a disagreement with particular findings by Ofgem or its reasoning. ScottishPower may disagree with this distinction, but there is no fundamental flaw in Ofgem's reasoning in this regard. Amongst other factors, Ofgem was influenced by the fact that ScottishPower had not indicated its intention to make a debt claim in its bid but this was a legitimate exercise of its case by case decision making. Ofgem was entitled to move through an analysis of the facts of the claim and consideration of its statutory duties, towards a regulatory policy view on the specifics of customer debt costs. Accordingly, I am not persuaded that Ofgem's views are outside the range of reasonable views open to it or that there is any fundamental flaw in the reasoning process that would vitiate its view in this regard.

99. Ground 2 fails.

Ground 3: Ofgem failed to give adequate reasons for its decision.

ScottishPower Submissions

100. ScottishPower submitted that the reasons in the decision letter is manifestly inadequate. There is no explanation why Ofgem considered consumer debt to be different to other costs which ScottishPower claimed. The statement that consumer debt is outside the "reasonable scope" of the basis on which ScottishPower was appointed as SoLR is unexplained. No attempt is made to explain what the "scope" of an LRSP payment is, and why. Insofar as the claimed scope is that a claim should "principally" be for the costs of credit balances and those associated with migrating customers, no reasoning is provided for that statement, nor why this is Ofgem's "expectation". No explanation was provided for why it was said to be unreasonable for the wider industry to "fund" the commercial risks associated with the cost of debt yet not the commercial risks associated with other heads of its claim. No explanation is given for the "balance" referred to by Ofgem, as between the recovery of consumer debt, the ability of the SoLR to recover legitimate and efficient costs and protecting the interests of consumers. If the claim was rejected due to an alternative policy, that a claim will not ordinarily be allowed unless identified in a SoLR's bid this was not explained in the decision. ScottishPower has been substantially prejudiced by Ofgem's failure to provide an adequately reasoned decision in that it is unable to understand the basis of the decision.

Discussion

Relevant legal principles

101. It was common ground that Ofgem has a statutory duty to give reason (s. 49A of the Electricity Act 1989 and s. 38A of the Gas Act 1986). The standard of reasoning was also common ground*:*

Reasons must be intelligible and adequate, so as to enable the reader to understand why the matter was decided as it was and what conclusions were reached on the 'principal important controversial issues. They can be briefly stated, the degree of particularity required depends entirely on the nature of the issues falling for decision. The reasoning must not give rise to a substantial doubt as to whether the decision-maker erred in law. But such adverse inference will not readily be drawn. Decision letters must be read in a straightforward manner, recognising that they are addressed to parties well aware of the issues involved and the arguments advanced. A reasons challenge will only succeed if the party aggrieved can satisfy the court that he has genuinely been substantially prejudiced by the failure to provide an adequately reasoned decision

(South Bucks District Council v Porter (No.2) [2004] UKHL 33 at §36).

Application of the principles to the reasons in this case

102. Ofgem's reasons for refusing the debt claim, set out in its final decision letter, explain that it regarded customer debt as different to the other costs claimed which are 'directly related' to refunding credit balances and 'on boarding' customers. Its decision in this regard was not inconsistent with its decision to allow recovery of service/operation and data quality costs which were finely balanced. Nor was it bound to consent to debt costs, by virtue of having consented to these other costs. The debt claim is outside the reasonable scope of the basis on which ScottishPower was appointed and any LRSP claim. Ofgem's expectation is that a claim will be principally for the cost of credit balances and costs associated with migrating customers from the failed supplier. Taking account of all the circumstances of the case and having regard to its duty to protect consumers, the claim was not a reasonable cost to be recovered via the industry levy. Whilst Ofgem was open to a range of costs forming part of a claim for a LRSP, it considered that a decision not to consent to the recovery of consumer debt sets the most appropriate balance between the ability of a SoLR to recover legitimate and efficient costs and protecting the interests of consumers.

103. In my judgment, these reasons are adequate and intelligible. They explain the main bases for its decision and respond to key submissions advanced by ScottishPower in making its claim (consumer debt is no different from other heads of claim and Ofgem's decision is inconsistent with its decision on other heads of claim). Reasons may be briefly stated and Ofgem is not writing an examination paper (South Bucks at §26 citing South Somerset District Council v Secretary of State [1993] 1 PLR 80, 83)). The reasons do not reveal any error in law or anything 'substantially wrong' or 'inadequate' (South Bucks at §25 citing the Westminster case [1985] AC 661, 673). They show Ofgem exercising its discretion on a case by case basis in light of its principal statutory objective to protect the interests of consumers. ScottishPower's submissions on this ground amount to a request for further explanation of Ofgem's reasons.

104. In any event, a reasons challenge will only succeed if the party aggrieved can satisfy the court that it has genuinely been substantially prejudiced by the failure to provide an adequately reasoned decision (South Bucks §36 per Lord Brown). I am not so satisfied. It is simply not credible, in the circumstances of this particular decision making, for

ScottishPower to suggest, as it does, that it has suffered prejudice because it has been "*unable to understand the basis of the Decision*". On receiving the claim, Ofgem held two meetings with the company to gather information and understand its position. In between the meetings it sent additional questions on the claim. Having come to an internal view on the claim Ofgem shared a summary of its view with ScottishPower. It offered to meet with ScottishPower to discuss its position, an offer accepted by ScottishPower on the basis that a meeting would enable it to "*go through each area in detail and understand more fully Ofgem's position*" as well as to "*share any further thoughts that we have on those areas Ofgem is minded not to accept at this point*'. There followed a telephone call and a meeting at which ScottishPower presented slides addressing each of Ofgem's reasons for rejecting the claim for debt-costs. Ofgem followed up the meeting with a written response by email in the same month. ScottishPower recorded its view of the meeting in an internal e-mail, stating that Ofgem: "*noted they would review the detail within the slides, noting that it was a helpful meeting and the points we shared were useful. [The Ofgem representative] noted that Ofgem had already considered our claim in a lot of detail, but they would consider the additional detail we provide and come back to us.*" ScottishPower had the opportunity to respond to the industry consultation, in which Ofgem explained its decision-making process and methodology, setting out its reasoning on the wider claim, including the debt claim. It is apparent from the chronology of decision making that Ofgem was in repeated contact with ScottishPower over an extended period. Ofgem repeatedly explained its thinking and ScottishPower had every opportunity to understand the basis of its decision.

105. Ground 3 fails.

Conclusion

106. For the reasons set out above, the claim fails.