

Gas and Electricity Suppliers,
Electricity Distribution Network
Operators,
Gas Transporters and all other
interested parties

Email: solrlevyteam@ofgem.gov.uk

4 November 2022

Dear Colleague

Last Resort Supply Payment Claim from E.ON Next Energy Limited

On 07 October 2022, E.ON Next Energy Limited (“E.ON Next”) gave notice to Ofgem of its intention to make a claim for a Last Resort Supply Payment (LRSP). E.ON Next is seeking to recover additional, otherwise unrecoverable costs incurred in acting as Supplier of Last Resort (SoLR) to customers of the former Hub Energy Limited (“Hub Energy”).

Under Standard Licence Condition (SLC) 9.1 of the Supply Licence, SoLRs are entitled, provided Ofgem consents, to make a claim for a LRSP from each Relevant Gas Transporter and Electricity Distribution Network Operator. The claim from E.ON Next included its calculation of the claim amount and information to support the calculation (outlined in Table 1).

This letter sets out the reasons why we are minded to consent to E.ON Next claiming a LRSP of up to £1,337,711.47. This total is subject to recalculation of the working capital figure by E.ON Next. Due to deductions made on other cost categories, we are unable to undertake the calculations on working capital to arrive at an allowed amount, but the deductions made in other categories mean that this figure claimed is likely to decrease. We therefore require E.ON Next to resubmit their working capital calculation no later than the end of the day on **Tuesday 8th November 2022**.

We are minded to allow E.ON Next to claim for costs incurred in complying with a Last Resort Supply Direction¹ relating to:

- protecting the credit balances owed to former customers of Hub Energy;
- working capital costs incurred on becoming a SoLR, subject to recalculation of the working capital element of the claim by E.ON Next;
- other costs reasonably incurred on becoming a SoLR.

The purpose of this consultation letter is to provide interested parties with an opportunity to make any representations to us, ahead of us making our final decision. We will take such representations into account in our final decision making and may make changes to our

¹ <https://www.ofgem.gov.uk/publications/direction-appoint-eon-next-energy-limited-electricity-supplier-last-resort> and <https://www.ofgem.gov.uk/publications/direction-appoint-eon-next-energy-limited-gas-supplier-last-resort>

minded to position in response to such representations, if we consider it appropriate to do so.

In addition, before we make our final decision we will conduct an additional assurance process in respect of the calculations contained in our minded to position, the results of which may also be reflected in our final decision.

We expect to make our final decision in mid-December 2022.

Background

The SoLR process

Electricity and gas supply is a competitive activity in Great Britain. While competition has the potential to bring many benefits to consumers, in a competitive market, companies that are not operating efficiently may fail. This applies as much in relation to the gas and electricity supply markets as it does to other markets.

It is Ofgem's statutory duty to protect customers' interests when suppliers fail. When a supplier fails, our focus is to ensure continuity of supply for its customers and to minimise wider negative impacts on the market. These wider effects stem from the fact that if an energy supplier fails, its customers will continue to be physically supplied with gas and/or electricity, but the supplier will not be able to meet the costs of providing this energy. In these circumstances, the costs of procuring the necessary energy will be spread across all domestic suppliers and the costs of procuring gas will fall to the relevant shipper. There is also the real risk that if a supplier fails without urgent intervention, consumer trust and confidence in the energy market would be materially damaged.

Ofgem can ensure continuity of supply to the failed supplier's customers and minimise these wider negative effects by appointing a SoLR, which is issued with a Last Resort Supply Direction requiring it to supply the failed supplier's customers at very short notice².

Hub Energy event

On 12 August 2021, we appointed E.ON Next as the SoLR³ for Hub Energy gas⁴ and electricity⁵ customers, following its announcement that it had ceased trading. This followed an appointment process aimed at getting the best deal for consumers. We outlined the material factors behind our decision to appoint E.ON Next as the SoLR to those customers in our decision letter published on 06 September 2021⁶.

Claim for Last Resort Supply Payment

² The obligation for a supplier to comply with a LRSD derives from standard licence condition 8 of each supplier's gas and electricity supply licences and is intended to ensure a universal service for Great British energy consumers (for further information on this universal service, see Articles 3(3) of the EU Directives 2009/72/EC and 2009/73/EC).

³ <https://www.ofgem.gov.uk/publications/ofgem-appoints-eon-next-take-customers-hub-energy>

⁴ <https://www.ofgem.gov.uk/publications/direction-appoint-eon-next-energy-limited-gas-supplier-last-resort>

⁵ <https://www.ofgem.gov.uk/publications/direction-appoint-eon-next-energy-limited-electricity-supplier-last-resort>

⁶ <https://www.ofgem.gov.uk/publications/appointment-eon-next-energy-limited-supplier-last-resort>

Under SLC 9.1 of the Supply Licence, SoLRs are entitled, with Ofgem's consent, to make a claim for a Last Resort Supply Payment ("LRSP") from each Relevant Gas Transporter and Electricity Distribution Network Operator.

SLC 9.4 provides that the total amount of the LRSP must not exceed the amount by which the total costs (including interest on working capital) reasonably incurred by the SoLR in supplying customers under the Last Resort Supply Direction and a reasonable profit plus any sums paid or debts assumed by the SoLR to compensate customers in respect of any customer credit balances plus any additional (actual or anticipated) interest and finance costs associated with a financing arrangement approved under SLC 9.7C are greater than the total amounts recovered by the SoLR through charges for that supply.

SLC 9.6 makes clear that Ofgem may determine that an amount other than the one calculated by the SoLR is a more accurate calculation of the relevant amount and, in such cases, the amount specified by Ofgem must be treated as the relevant amount when the licensee submits its claim to each relevant electricity or gas network licensee in accordance with SLC 9.8.

LRSPs are paid for by the relevant gas and electricity network operators, who then recover the cost through charges to suppliers. SLC 38B of the Electricity Distribution Licence and Standard Special Condition A48 of the Gas Transportation Licence set out the details of this.

Our decision process and methodology

Under SLC 9.5, Ofgem must decide whether it is appropriate in all the circumstances of the case for the SoLR to make the claim notified to it in accordance with Standard Licence Condition 9.3.

Our process to reach our minded-to position included:

- a. A quantitative check of E.ON Next's methodology for each cost item claimed. This included determining how each total cost item was calculated based on data sent to us by E.ON Next and ensuring these costs were in line with commitments E.ON Next made at the time of its SoLR appointment;
 - b. Undertaking validation of some assumptions with other data sources, where appropriate; and
 - c. A qualitative and quantitative assessment of the claim for costs related to credit balances, financing and other costs in accordance with our criteria and methodology, set out below.
- **Additional:** whether the costs claimed are additional to the costs to the SoLR of 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.
 - **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.

- **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 – or reasonably be expected to recover – through the administration process or customer charges, for example.
- **Economic:** whether the SoLR had made all reasonable efforts to avoid the cost in the first instance or absorb the cost.

E.ON Next claim

E.ON Next indicated at the time of our SoLR appointment process that it would not waive its right to make a claim for LRSP costs and that it would claim for the cost of honouring domestic customer credit balances, the cost of working capital, and certain other costs.

Summary of our minded-to decision

Based on the specific circumstances of this levy claim case and the information available to us, Ofgem is minded to consent to E.ON Next claiming a LRSP of up to £1,337,711.47. This total is subject to recalculation of the working capital figure by E.ON Next.

Under the supplier SLCs we are required to consider on a case-by-case basis whether in the circumstances it is appropriate for a SoLR to make a claim for a LRSP. We have set out below our reasons for our minded-to position for this case. 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.

Table 1: Summary table of claim minded-to position on final claim amounts.

Item	Cost	Cost Claimed (£)	Deductions (£)	Minded-to position on claim (£)
1	Credit balances	813,270.82	6,012.68	807,258.14
2	Working capital	152,459.34	0	152,459.34
3	Other costs: operational, tech/IT, resourcing and administrator costs	421,209.70	43,215.71	377,993.99
	Total	1,386,939.86	49,228.39	1,337,711.47

Reasons for our minded-to decision

Cost category: Credit balances

Our published guidance sets out that we may in certain circumstances consider it appropriate to approve a claim associated with costs incurred in repaying credit balances to customers who had a positive credit balance with a failed supplier.

Decision:

E.ON Next's claim for credit balance costs of £813,270.82 includes:

- £738,112.36 for the cost of refunding credit balances owed to customers of Hub Energy when the company ceased trading ('open accounts'), and
- £75,158.46 for the cost of refunding credit balances owed to former customers of Hub Energy who had switched to another supplier at the point the company ceased trading ('closed accounts').

We consider that the claimed amount for honouring the credit balances of open accounts is consistent with our criteria and we are minded to consent to the claim. However, we do not consider that E.ON Next has provided sufficient evidence for the claimed amount for honouring the credit balances of closed accounts. Therefore, we are minded to consent to this portion of the claim on the condition that E.ON Next can provide sufficient evidence that all refunded credit balances have been received by the customer, or the uncashed refund cheques have been removed from its claim.

Table 3: Summary of claims and minded to position for credit balances

Item	Cost	Cost Claimed (£)	Deductions (£)	Minded-to position on claim (£)
1	Credit balances	813,270.82	6,012.68	807,258.14

Rationale for decision:

E.ON Next has requested our consent to recover £813,270.82 through a LRSP for the cost of refunding credit balances to customers and former customers of Hub Energy at the time the company ceased trading. Under Supplier SLC 9.4(b) a SoLR may claim any sums paid or debts assumed to compensate customers of the failed supplier respect of any customer credit balances.

We are satisfied in this case that the claimed amount and corresponding evidence for open account credit balances is consistent with our assessment criteria outlined above for a valid LRSP claim, and the calculations E.ON Next has made are accurate for its submitted claim. In addition to customer account-level data of each open and closed account credit balance, E.ON Next also provided an explanation of its process of determining customer credit balances with the administrator that set out the activities it undertook to best ensure the accuracy of customers' final meter reads. E.ON Next confirmed that through its engagement with the administrator it was not aware of credit balances being made up of anything other than customer payments. Additionally, Hub Energy was not a Warm Home Discount provider. We consider that the claim is consistent with E.ON Next's commitment

at the time of its appointment as SoLR for customers of Hub Energy. Given this, we are minded to approve this portion of the claim as set out below.

As part of our assessment of the closed account credit balances, our position is that amounts of credit balance refunds made by cheque should only be recovered by the supplier through the levy once that cheque is cashed. We do not consider that it would be appropriate to allow SoLRs to claim for closed account credit balance cheques until the point that they are actually cashed for the following reasons:

- To avoid consumers bearing the cost of compensation for credit balances never in fact received by customers of the failed supplier.
- To ensure that the SoLR does not profit from a situation where some credit balance cheques are never presented; and
- Noting that a future LRSP claim can be made so that E.ON Next can recover the cost of any credit balance cheques presented after the cut off point for the current claim.

E.ON Next has so far been unable to provide a breakdown of cashed and uncashed cheques specifically for its SoLR customers. E.ON Next provided an alternative methodology for the calculation of the likely amount of uncashed cheques that we believe is a sensible alternative when detailed data is not available. However, E.ON Next have not submitted evidence to explain their calculations in their methodology so we are unable to make a decision. However, at this stage, we are minded, in principle, to allow this portion of the claim, taking into account the deduction using the methodology proposed by E.ON Next, provided that E.ON Next provides further evidence to support its calculation based on the alternative methodology in order to allow us to validate the calculations in the alternative methodology.

As noted above, in cases where individual customer-level data is not available we will assess on a case by case basis the appropriateness of utilising alternative means to determine the level of uncashed refund cheques. We will engage with E.ON Next through the consultation period and will assess any alternative methodology and supporting evidence in line with our process and criteria outlined above ahead of making our final decision.

We have considered whether the costs E.ON Next is seeking to claim for credit balances are otherwise unrecoverable; it may still be the case that E.ON Next is able to recover some of this claimed amount through the ongoing administration process for Hub Energy, to which E.ON Next has, in accordance with the requirements of the LRSP process, submitted a subrogated creditor claim for the sums paid to compensate customers for costs incurred in repaying credit balances. We propose to make our final decision on E.ON Next's claim ahead of the conclusion of the liquidation process, the timescale of which is uncertain. Given this, we are minded to approve this element of the claim, subject to the outcome of the Simplicity liquidation process.

At this point, the final amount E.ON Next can claim would be adjusted to include costs recovered through the liquidation process.

Cost category: Working capital

In the period between its appointment as SoLR and recovering funds through the industry levy, E.ON Next may have incurred costs in making capital available to fund costs associated with the SoLR process. Suppliers must demonstrate, with evidence, that their financing cost claim delivers value for money for consumers and is the best possible rate they could achieve given their individual circumstances.

While a SoLR may seek to claim for financing costs via a LRSP and within the legal framework within which we operate, we are mindful of the pressures that consumers have been facing with the rising cost of energy. Given that the costs SoLRs claim for via a LRSP are ultimately borne by consumers, we would expect SoLRs also to be very mindful of these pressures and take this into account when determining the costs that the SoLR decide to claim through the SoLR levy. In particular, in circumstances where financing costs arise from parent/intra-group arrangements, we would expect the Company Group to consider very carefully whether it is appropriate for their Supply business to be claiming working capital costs at all and, if so, what rate is reasonable, when many consumers are struggling to be able to pay their energy bills.

Decision:

E.ON Next’s claim includes £152,459.34 for the cost of working capital. The calculation includes actual costs incurred and the timescale for the recovery of those costs.

We did not receive sufficient evidence ahead of our minded-to position that allowed us to assess the claimed costs against our criteria effectively or undertake the qualitative and quantitative analysis that we require as set out in our process. However, in principle, we are minded to allow the claim for working capital costs provided that the evidence that is given to us before the end of the consultation period satisfies our overall assessment criteria. This includes E.ON Next making the necessary changes to its working capital calculations to reflect any costs we have disallowed from the overall claim.

Table 4: Summary of claims for working capital

Item	Cost	Cost Claimed (£)	Deductions (£)	Minded-to position on claim (£)
2	Working capital	152,459.34	0	152,459.34

Rationale for decision:

When a SoLR is appointed, it incurs costs associated with taking on the new customers which need to be financed. There are a range of ways in which a SoLR can finance this activity. Regardless of the finance option used, there is a cost in doing so. Under Supplier SLC 9.4(a) a SoLR may claim total costs (including interest on working capital) reasonably incurred in supplying premises under the Last Resort Supply Direction.

E.ON Next submitted a claim for the cost of working capital amounting to £152,459.34. It submitted evidence that detailed its expenditure relevant to its claim for working capital costs, as well as justification for why it had applied the interest rate that it had. This included an explanation that E.ON Next maintained their cost of capital rate at their 2021 level rather than increasing it to those reflected across their group in 2022. Based upon our assessment of the submitted evidence against our overall criteria, which included reviewing commitments made when E.ON next was appointed as SoLR and comparing the rate

against all other claims submitted to Ofgem on 7 October 2022, we are satisfied that E.ON Next has provided adequate evidence to demonstrate the rate of interest they faced in respect of working capital costs is reasonable in these particular circumstances and for these purposes only, within the regulatory framework.

As noted above, we were not provided with sufficiently detailed evidence by our 07 October deadline that would allow us to undertake a quantitative assessment of the methodology and calculations underpinning the submitted claim for the cost of capital ahead of our minded to position. However, we believe that E.ON Next's proposed rate is reasonable when compared against the range of rates secured for initial claims and the overall market movements since the submission of initial claims. As we have so far been unable to fully assess the submitted claim we are minded, in principle, to allow E.ON Next's claim for working capital costs provided that, following our full assessment of all the evidence, we are satisfied the claimed costs meets our assessment criteria outlined above. The evidence necessary for our assessment will include E.ON Next's recalculation and resubmission of its evidence to account for any deductions we are minded to make to its overall claim that impact upon its working capital cost calculations.

As set out above, we consider that the rate at which working capital has been calculated is consistent with our criteria and reasonable in these cases and for these purposes only. However, working capital may only be claimed on costs that meet our criteria for assessing claims. In light of our minded-to position to make deductions to E.ON Next's claim for internal resourcing, we are unable to undertake the calculations on working capital to be able to make a decision on the amount to be allowed for working capital. As such, the total amount of working capital claimed for of £152,459.34 is subject to E.ON Next resubmitting a revised working capital claim taking into account the deductions in this minded to position. As explained above, in order to fully assess the working capital aspect of the claim, we therefore require E.ON Next to recalculate the working capital element of their claim for Hub Energy using, as costs incurred, the amounts we state in this document we are minded-to consent to.

When recalculating the working capital element of their claim, we expect E.ON Next to follow the same methodology, and apply the same rate, as their previous submission, clearly set out which costs have been reduced or removed. We also ask that E.ON Next submit their full calculations in sufficient detail to allow us to work out what their working capital allowance should be, without having to revert to E.ON Next.

Cost category: "Other costs"

We understand that other costs may have been incurred when undertaking activities as part of becoming a SoLR (for example, operational costs). As noted above, we have used our overarching criteria to assess whether these costs are appropriate and should be recovered through a LRSP. The other costs that E.ON Next has claimed are detailed below alongside our minded-to position.

Decision:

E.ON Next's claim seeks consent to recover £421,209.70 in other costs. These costs were incurred from operational costs of migrating of customers onto E.ON Next's customer platform and communication with customers to keep them informed about the process, a Transitional Services agreement with Hub's administrators, and internal resourcing costs to support the process. We do not consider that the £43,215.71 claimed for internal

resourcing costs is consistent with our criteria. Therefore, we are minded to consent to a claim of £377,993.99, following the deduction of £43,215.71 for internal resourcing costs.

Table 3: Summary of claims for “other costs”

Item	Cost	Cost Claimed (£)	Deductions (£)	Minded-to position on claim (£)
3	Other costs: operational, tech/IT, internal resourcing and administrator costs	421,209.70	43,215.71	377,993.99

Rationale for decision:

Tech/IT costs:

E.ON Next’s claim includes £101,469.00 for technological and IT incurred costs in migrating Hub Energy’s customers onto E.ON Next’s customer platform.

We are aware that at the time that E.ON Next acquired the SoLR customers from Hub Energy, E.ON Next was migrating to a new customer platform across its business. In the process of our assessment, we considered whether these costs claimed would have been expected at the time of the SoLR’s bid and we are concerned that these costs may not be additional to the costs to the SoLR of existing customers, as we have not received evidence from E.ON Next demonstrating that generic programme costs of their broader migration were excluded from their migration costs claimed.

At this stage therefore, we are not fully satisfied that the evidence provided to support this portion of the claim meets our criteria that the costs incurred must be additional. We are also not fully satisfied that the costs claimed for migration have been shown to be directly incurred as part of the SoLR role – that is, whether the costs were incurred as a result of taking on customers in an emergency situation as opposed to normal customer acquisition routes.

However, we agree in principle that migration costs of customers acquired through the SoLR process may be additional and a direct result of acting as a SoLR in an emergency situation. As a result, we are minded, in principle, to allow E.ON Next’s claim of £101,469.00 for costs incurred in migrating customers onto its customer platform provided that it provides further evidence within the consultation period that these costs were over and above costs E.ON Next would have incurred if these customers were acquired outside of the SoLR process, and through normal customer acquisition routes.

Operational Costs:

E.ON Next’s claim includes £796.99 for costs incurred as result of contracting with a third-party to send communications to SoLR customers to keep them informed about their transition.

We have assessed the evidence provided, including detailed invoices of direct costs incurred through SoLR activity and narrative explanations of the reasons for choosing the third-

party, and are satisfied that the costs claimed meet our criteria. In particular, we are satisfied that these costs are otherwise unrecoverable and we are satisfied with the processes put in place to minimise the costs to consumers. We consider that the costs claimed for dealing with these operational issues are a direct result of E.ON Next's appointment as SoLR and are additional to those that it would have faced in the course of its normal retail operations.

We consider that the claimed amount is consistent with our criteria and we are minded to consent to the operational costs portion of the claim.

Resourcing costs:

E.ON Next's claim includes £43,215.71 for internal resourcing costs required to support the full SoLR process. We have assessed the evidence provided, including sample timesheets of internal resource allocation and narrative explanations, and we are not satisfied that the costs claimed meet our criteria. We do not consider that these costs are additional to those that E.ON Next would have faced in the course of its normal retail operations as these were existing staff who were transferred from their existing functions temporarily, and as such E.ON Next would have incurred their salary costs irrespective of the SOLR activity. This aligns with the position that we previously held when assessing initial claims during Winter 2021/22.

As such we consider that the claimed amount is not consistent with our criteria and we are minded not to consent to the resourcing costs portion of the claim.

Administrator costs:

E.ON Next's claim includes £275,728.00 for a Transitional Services Agreement with Hub Energy's administrators. We have assessed the evidence provided, including detailed invoices of direct costs incurred through SoLR activity and narrative explanations setting out E.ON's approach to negotiating with the administrator, and are satisfied that the costs claimed meet our criteria. We recognise that these costs were required for the successful transfer of customers of the failed supplier and were incurred as a direct result of E.ON Next acting as a SoLR in an emergency situation. We also consider that these administrator costs are additional to those that it would have faced in the course of its normal retail operations and are not recoverable in any other way. Based upon the evidence received, we are satisfied that the costs were incurred economically and that E.ON Next acted reasonably in seeking to minimise the costs to consumers.

Following our assessment of the evidence provided to us against our criteria outlined above, we consider that the claimed amount is consistent with our criteria and, in the particular circumstances of this case, we are minded to consent to the administrator costs portion of the claim.

Next steps

The purpose of this letter is to provide the SoLR and interested parties with an opportunity to make any representations to us, ahead of us making our final decision on this LRSP claim. We invite any representations by **30 November 2022**. Responses should be emailed⁷ to solrlevyteam@ofgem.gov.uk.

⁷ Although we prefer responses in electronic format, responses can be posted to the address below.

We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so that they can be placed easily on our website.

We will take into account all relevant information, including any representations we receive, and the results of our internal audit of our assessment process in reaching our final decision on E.ON Next claim. We expect to make our final decision in mid-December 2022.

Yours faithfully,

Neil Lawrence
Director, Retail Directorate