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for energy consumers

## All interested parties

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Date: 25 April 2019

Dear colleague,

### Appointment of Ovo Energy Limited as Supplier of Last Resort

On 11 January 2019, we announced that we had appointed Ovo Energy Limited (hereafter “**Ovo Energy**”) as the new supplier for Economy Energy Trading Limited’s (hereafter “**Economy Energy**”) gas and electricity customers<sup>1</sup> and issued our decision to revoke Economy Energy’s gas and electricity licences<sup>2</sup>, following an earlier announcement that Economy Energy had ceased trading<sup>3</sup>.

We appointed Ovo Energy as the Supplier of Last Resort (“SoLR”) for Economy Energy’s customers because their offer, taking into account all the relevant factors that are set out below, represented the best deal overall for both customers of Economy Energy and all energy consumers. This letter summarises the background to this process and the reasons<sup>4</sup> for our decision<sup>5</sup> to appoint Ovo Energy.<sup>6</sup> Further information on Ofgem’s safety net to make sure customers are protected if their supplier goes out of business is available on our website.<sup>7</sup>

### The SoLR process

Electricity and gas is supplied through markets and on the basis of a competitive process in Great Britain. While competition has the potential to bring many benefits to consumers, a competitive process occasionally leads to companies failing. This applies as much in relation to the gas and electricity supply markets as it does to other markets.

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<sup>1</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-appoints-Ovo-energy-take-customers-economy-energy>

<sup>2</sup> <https://www.ofgem.gov.uk/publications-and-updates/economy-energy-trading-limited-notice-revocation-gas-supply-licence> and <https://www.ofgem.gov.uk/publications-and-updates/economy-energy-trading-limited-notice-revocation-electricity-supply-licence>

<sup>3</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-protects-customers-failed-supplier-economy-energy>

<sup>4</sup> This letter constitutes the notice of our reasons for the purposes of section 38A of the Gas Act 1986 and section 49A of the Electricity Act 1989

<sup>5</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-appoints-Ovo-energy-take-customers-economy-energy> and <https://www.ofgem.gov.uk/publications-and-updates/Ovo-electricity-ltd-electricity-supplier-last-resort> and <https://www.ofgem.gov.uk/publications-and-updates/Ovo-gas-ltd-gas-supplier-last-resort>

<sup>6</sup> The obligation for a supplier (such as Ovo Energy) to comply with such an appointment 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). The duties of a SoLR are further described in our SoLR guidance and Ofgem’s direction notice contains specific details of Ovo Energy Limited’s obligations to Economy Energy Limited’s customers

<sup>7</sup> <https://www.ofgem.gov.uk/consumers/household-gas-and-electricity-guide/extra-help-energy-services/ofgem-safety-net-if-your-energy-supplier-goes-out-business>

When a supplier fails, our focus is to ensure continuity of supply for its customers and to avoid wider negative effects on the market. Such wider effects stem from the fact that a failing/failed supplier's consumers will continue to use energy that the supplier cannot pay for. This will result in costs that are mutualised across other industry participants until these customers are appointed to a SoLR. 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 prevent these wider negative effects by appointing a SoLR to supply the failed supplier's customers at very short notice.<sup>8</sup> This process also ensures that the credit balances of the failed supplier's customers are protected.

We can direct any licensee to be a SoLR but to ensure we appoint the company we think is best placed to take on this role we ask companies interested in being the SoLR to provide us with information including how they will cope with the bulk increase in purchasing power and customer service requirements, how they will treat customer credit balances, and the tariff they will put the customers on. Where possible, we also seek to appoint a company which has volunteered to act as a SoLR.

## **Background to this decision**

In January 2019, Economy Energy confirmed to us that it was in severe financial difficulties, at which point we prepared to commence the SoLR process, to ensure consumers were protected.

In accordance with our standard process and published SoLR guidance<sup>9</sup>, we undertook the following steps leading up to the decision we announced on 11 January 2019:

- We sought information from Economy Energy on their customer base and arrangements for supply, for the purposes of running the SoLR process;
- We sent information requests<sup>10</sup> to a number of licensed gas and electricity suppliers to submit offers for the terms on which they would be appointed a SoLR. Among other things, we asked suppliers for information on their willingness to act as a SoLR, their capability to supply the customers and the terms they proposed to offer customers if successful; and
- We sought relevant information from network licensees, and industry central systems bodies.<sup>11</sup>

## **Our decision**

On 11 January 2019 we announced our decision to appoint Ovo Energy as the SoLR, in order to ensure continuity of supplies of gas and electricity to Economy Energy's customers, and payment of appropriate charges under the industry arrangements. We also gave notice of our decision to revoke Economy Energy's licences.<sup>12</sup>

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<sup>8</sup> The obligation for a supplier to comply with a Last Resort Supply Direction (LRSD) derives from standard licence condition 8 of the 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)

<sup>9</sup> <https://www.ofgem.gov.uk/publications-and-updates/supplier-last-resort-revised-guidance-2016>

<sup>10</sup> In accordance with condition 5 of the Standard Licence Conditions for gas and electricity supply

<sup>11</sup> Elexon for electricity, Xoserve for gas, the Data Communications Company (DCC) for smart metering.

<sup>12</sup> Revocation of the supply licence is necessary for the SoLR arrangements to come into effect. The notices to revoke Extra's licences are published on our website: <https://www.ofgem.gov.uk/publications-and-updates/economy-energy-trading-limited-notice-revocation-gas-supply-licence> and <https://www.ofgem.gov.uk/publications-and-updates/economy-energy-trading-limited-notice-revocation-electricity-supply-licence>

In line with our published SoLR guidance, we considered all bids submitted by suppliers against a set of criteria. We have described the criteria we used in the SoLR selection process in the annex to this letter. All responses from suppliers contained confidential information. We have not released this information as to do so would be likely to prejudice future potential SoLR processes.

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 seven 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 Ovo Energy's proposal was the best deal for customers.

#### *Volunteers for the role of SoLR*

As set out in our SoLR guidance,<sup>13</sup> our preference is given to suppliers who volunteer to undertake the role of SoLR. Of the submissions we received, some including Ovo Energy– confirmed they wished to volunteer for this role.

#### *Honouring account balances*

As per our SoLR guidance, Ofgem operates a safety net through the SoLR process which protects consumers' credit balances.<sup>14</sup> We recognise that a key concern for customers of Economy Energy (both existing and past customers who may still have been owed money by Economy Energy) would be whether their credit balances would be honoured. Indeed after ensuring continuity of supply, protecting consumers' money (of existing and past customers), was one of the most important factors in our decision.

Of the submissions we received from suppliers, all – including Ovo Energy– confirmed they would honour the credit balances for Economy Energy's customers. Given the implications for overall consumer confidence, as noted above we also considered whether suppliers would honour the credit balances of former Economy Energy customers who had switched away but were still due a credit refund. The majority – including Ovo Energy – confirmed they would honour these credit refunds.

#### *Use of the industry levy*

The gas and electricity supply licences allow the SoLR to claim for reasonable additional costs incurred in taking on the failed supplier's customers through an industry levy or Last Resort Supply Payment ("**LRSP**") where Ofgem gives its consent<sup>15</sup>.

Our SoLR guidance states that our preference is for the SoLR to not make any claim under the levy (or to minimise the amount of such claim) as we expect them to be able to cover their own costs, and we want to reduce the costs smeared across the rest of the market<sup>16</sup>.

The majority of the suppliers who were willing to honour open and closed credit balances indicated their intention to use the levy to cover some or all the costs of honouring credit balances through the levy. Some suppliers intended to use the levy to cover all of the costs of honouring credit balances, with others offering to contribute to these costs or waiving any claim to the industry levy. Ovo Energy set out that they would not make a claim on the industry levy for any of their costs (that is any costs associated with being a SoLR or for honouring credit balances).

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<sup>13</sup> See paragraphs 3.2 to 3.4 of our SoLR guidance.

<sup>14</sup> See paragraphs 3.23 to 3.25 of our SoLR guidance and Ofgem's decision on our approach to dealing with supplier insolvency and its consequence for consumers, published in June 2016, a copy of which is available here: <https://www.ofgem.gov.uk/publications-and-updates/our-proposed-approach-dealing-supplier-insolvency-and-its-consequences-customers>

<sup>15</sup> Electricity and gas suppliers' licences permit them (in some circumstances) to make a claim for the otherwise unrecoverable costs that they have incurred in complying with our direction that they act as a SoLR. This would be paid by a "levy" on relevant gas transporters and electricity distributors who would pass these costs on to network users through their Use of System charges.

<sup>16</sup> See paragraphs 3.5 to 3.7 of our SoLR guidance.

## *Price*

Our SoLR guidance states that the deemed tariff onto which the customers of the failed supplier are moved must not reflect more than the reasonable costs of supply (including costs attributable to the purchase of gas or electricity at short notice), together with a reasonable profit.<sup>17</sup>

We analysed each of the deemed contract prices put forward by the suppliers who submitted offers to be appointed as the SoLR, and calculated a Typical Domestic Consumption Value (TDCV) annual bill figure. We took the prices being charged into consideration as part of the deal for customers, with a general preference of minimising additional charges that consumers might face, provided that the prices were not contingent on recovery of expected supply costs from the levy. The tariff offered by Ovo Energy was in line with the price cap and when balanced against their commitment not to make a levy claim represented the lowest cost to customers overall.

## *Customer service*

It is to be expected that the customers of a failed supplier, who have been switched through the SoLR process, will have enquiries for their new supplier. Therefore, it is important that the SoLR has a robust approach for managing this increase in customer enquiries and for proactively informing their new customers about their new supply arrangements and available options.<sup>18</sup> In addition, to ensure a smooth transition for customers of the failed supplier, a SoLR will need to have adequate systems and processes in place for managing a large volume of new customer and supply point data in a timely way.

Bidders put forward a range of solutions to “onboarding” Economy Energy’s customers; we closely assessed each of these. Ovo Energy were able to provide a sufficient level of reassurance regarding continuity especially for consumers who were on smart pre-payment meters, which we concluded would be in the best interests of customers, in comparison with other approaches<sup>19</sup>.

## *Ability to supply gas and electricity and industry processes*

It is essential that the SoLR can comfortably manage the extra costs arising from sourcing the energy required to supply the failed supplier’s customers without jeopardising supply to their existing customers.<sup>20</sup> In making our decision, we considered a range of relevant factors which indicated the ability of the suppliers to absorb these costs, including:

- access to working capital and any guarantees in place;
- access to the relevant wholesale markets and products and management of wholesale energy trading and balancing;
- the amount of headroom the bidder has – i.e. the degree to which they have already covered their liabilities (in terms of energy) for this winter and the rest of the year; and
- their strategy to cover the new energy they will need to buy to cover the demand of Economy Energy’s customers.

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<sup>17</sup> See paragraphs 3.23 to 3.25 of our SoLR guidance, and standard licence conditions 8.6 and 8.7 of the gas and electricity supply licences

<sup>18</sup> See paragraphs 3.14 to 3.22 of our SoLR guidance.

<sup>19</sup> Since appointment of Ovo Energy as the SoLR for Economy Energy customers we have become aware of some customer service issues in respect of their Pre-Payment Meter customers. We worked actively with Ovo to ensure that these issues were addressed quickly.

<sup>20</sup> See paragraphs 3.8 to 3.13 of our SoLR guidance

We considered that Ovo Energy provided a sufficient explanation of its capacity and capability to manage the purchasing requirements relating to Economy Energy's customers. In addition, Ovo Energy have a history of adequate compliance with industry code requirements for gas transportation and electricity settlement and distribution, and smart metering.

## **Conclusion**

Considering all of the above in the round and in line with our published SoLR guidance, and taking into account our statutory duties including our principal objective to protect the interests of consumers, we reached the view that it would be in customers' best interests for Ovo Energy to be appointed the SoLR for Economy Energy's customers.

Yours faithfully,

**Philippa Pickford**  
**Director, Future Retail Markets**

## Annex 1: Summary of SoLR selection criteria

### Ofgem Supplier of Last Resort Selection Framework

Ofgem's principal objective is to protect current and future energy consumers. In the context of a supplier failure, our priority is to ensure that all customers continue to receive supplies of electricity and gas and to provide a safety net to protect domestic consumers' credit balances. As such, our preference is to appoint a Supplier of Last Resort who has agreed to **honour credit balances for both existing and former customers of the failed supplier**.

Through our supplier of last resort (SoLR) powers, we can direct any gas or electricity supply licensee to take over responsibility for a supplier's customers (i.e. to be a SoLR) after revocation of the failed supplier's licence.

In considering which supplier to direct in this way, we must be satisfied that the SoLR could supply the 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.

We would always prefer to appoint a SoLR that had consented to the role. However, if no suitable supplier wants to be a SoLR, we will consider using our powers to direct a supplier without its consent. The framework set out in this document provides information to potential SoLRs on the factors that Ofgem will consider in reaching a decision on appointing a SoLR. The framework sets out the issues Ofgem will consider and a judgement will be made looking across all the criteria and other relevant information.

Further information on the SoLR process is set out in our guidance<sup>21</sup>.

### Ofgem Preferences

1. Other things being equal, preference will be given to:
  - a. suppliers who volunteer for the role of SoLR
  - b. suppliers who honour, or compensate for, credit balances of the **existing customers** of the failing supplier
  - c. suppliers who provide protection through ex-gratia payments to **former customers** of the failing supplier with a closed credit account balance
  - d. suppliers who state that they will not make a claim for a Last Resort Supply Payment pursuant to standard condition 9 of the supply licence, and where suppliers who do not waive their right to a levy claim, minimise the expected size of that claim, and commit to exclude costs which they expect to incur if appointed SoLR from any future claim<sup>22</sup>
  - e. suppliers who minimise the extent of price increases – if any – for the customers of the failing supplier

### Core Criteria

#### Ability to supply and industry codes

2. The SoLR should have arrangements in place to source the additional gas and electricity required for any customers acquired as part of a Last Resort Supply Direction, while enabling it to continue to supply its existing customers
3. The SoLR's shipper must have signed the appropriate Network Codes for the licensed gas transporters on whose networks the Licensee may be a SoLR
4. The Licensee must have entered into Distribution Use of System Agreements with all distribution companies in whose areas it may be a SoLR

<sup>21</sup> Ofgem, Supplier of Last Resort: Revised Guidance 2016, October 2016

<sup>22</sup> Although we recognise that the circumstances of a specific supplier failure may justify a SoLR making a claim, an efficient SoLR should be able to minimise its exposure to these costs

5. The Licensee must have acceded to the Smart Energy Code
6. SoLR should be a DCC user
7. The SoLR or its shipper must be able to comply with current credit cover rules of industry codes

#### Customer engagement

8. What arrangements the SoLR will make to deal with the customers of the failing supplier, including:
  - a. how customers will be informed about what has happened and provided with named contact details that they can use to ask any questions
  - b. how customers' written and telephone enquiries will be dealt with
  - c. how the SoLR will ensure that customers will receive a timely and accurate bill
  - d. how communication with any smart meters will be managed
  - e. how customers will be made aware of their options to sign up to a contract with the Licensee or another supplier
  - f. information on recent customer service standards and on any recent investigation or enforcement action in connection with customer service functions
9. The SoLR must be able to operate the relevant change of supplier processes to minimise disruption to new and existing customers and other industry participants.
10. The SoLR must have adequate arrangements in place to deal with customer queries (including both new and existing customers).