

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

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Dear Colleague,

Last Resort Supplier Payment Claim from Ovo Energy Limited

Following its appointment as a Supplier of Last Resort ("SoLR") Ovo Energy Limited ("Ovo Energy") gave notice to Ofgem of their intention to submit a claim for a Last Resort Supply Payment ("LRSP"). Ovo Energy is seeking to claim additional costs incurred in acting as SoLR to customers of the former Spark Energy Supply Limited ("Spark Energy").

As per Supply Licence Condition 9, a SoLR may make a claim for a LRSP from relevant distribution networks where we have given our consent to the amount claimed. The claim from Ovo 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 Ovo Energy claiming a LRSP of up to £13.1m¹. We are minded to allow Ovo Energy to claim for a portion of the costs of protecting the credit balances owed by Spark Energy to the customers Ovo Energy acquired, in line with commitments given at the time of the SoLR appointment.

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 currently expect to make our final decision in January 2020, to enable the agreed amount to be recovered from relevant distribution network companies in 2020/21².

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 in light of supplier failure. 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

¹ £13,080,509.

² We currently expect to take a decision in January 2020 in time for relevant Gas Distribution Network (GDN) companies to make payment of the relevant share of the LRSP claim in charging year 2020/21. Relevant Electricity Distribution Network Operators (DNOs) are required to begin payment no later than 3 months after being presented with a valid LRSP claim and to complete payment within a further period of 12 months.

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 electricity will be smeared across all 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 to supply the failed supplier's customers at very short notice.³

Spark Energy Supply Limited SoLR event

On 27 November 2018, we appointed Ovo Energy as the SoLR⁴ for Spark Energy's gas and electricity customers following its announcement that it had ceased trading. This followed a competitive process aimed at getting the best deal for consumers, in line with our principal objective to protect the interests of existing and future consumers and our published guidance.

At the time of Spark Energy's failure, we received a number of submissions from suppliers, setting out the terms they would offer to customers if they were to be appointed as the SoLR. We outlined the material factors behind our decision to appoint Ovo as the SoLR in our decision letter published on 26 April 2019⁵.

Claim for 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 they incur in complying with a Last Resort Supply Direction (LRSD)⁶.

As part of their competitive bid to become a SoLR, a supplier will include whether they expect to make a claim for a Last Resort Supplier Payment, or whether they wish to waive this right. As stated in our revised 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.

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.

Ovo Energy indicated at the time of the SoLR appointment process that it would not waive its right to make a claim and that it would claim only for a portion of the cost of honouring credit balances.

³ The obligation for a supplier (such as Ovo Energy) 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). The duties of a SoLR are further described in our Guidance and the LRSD contains specific details of Ovo Energy's obligations to supply Spark Energy's former customers.

⁴ <https://www.ofgem.gov.uk/publications-and-updates/ofgem-appoints-ovo-energy-take-customers-spark-energy-supply-limited>

⁵ https://www.ofgem.gov.uk/system/files/docs/2019/02/190212_solr_decision_letter_spark_ovo.pdf

⁶ <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-ovo-electricity-ltd-electricity-supplier-last-resort> and <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-ovo-gas-ltd-gas-supplier-last-resort>

Ovo Energy SoLR Levy claim

Item	Cost Category associated with SoLR	Cost item to be claimed by Ovo Energy (£)
1	Credit balances – cost of 60% of credit balance liability	£ 13,080,509

Ovo Energy is self-funding a portion (40%) of the credit balance liability which it assumed in its role as a SoLR.

Our decision process and methodology

Our process to reach our minded-to position consisted of:

- A quantitative check of Ovo Energy's methodology for each cost item claimed. This included determining how each total cost item was calculated based on data sent to us by Ovo Energy and ensuring these costs were in line with commitments Ovo Energy made at the time of its SoLR appointment
- Undertaking validation of some assumptions with other data sources, where appropriate
- A qualitative assessment of the claim for credit balances against our methodology criteria.

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 to some extent 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.

Our minded-to decision

On balance, given all specific circumstances of this levy claim case and taking into consideration all information available to us, we are minded to consent to Ovo Energy claiming a Last Resort Supply Payment of up to £13.1m⁷.

If we are able to make a decision in the timescale anticipated our position would enable Ovo Energy to recover up to the amount consented to from relevant distribution network companies in 2020/2021⁸. This is subject to any costs recovered from the liquidation process.

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 on the levy. 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.

Reasons for our minded-to decision

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. We are satisfied in this case that (subject to the points discussed below) the claimed amount is consistent with the relevant criteria and in particular, is consistent with Ovo Energy's commitment in its SoLR bid.

In applying for the SoLR role, Ovo committed to claiming only for a portion of the cost of honouring credit balances, and the claim Ovo is seeking to make is in line with the portion it committed to at the time. We have considered whether the costs Ovo Energy is seeking to claim for credit balances are otherwise unrecoverable; it may still be the case that Ovo Energy is able to recover some of this claimed amount through the ongoing administration process for Spark Energy. We propose to make our final decision on Ovo Energy'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 Spark Energy liquidation process. At this point, the final amount Ovo Energy can claim would be adjusted to include costs recovered through the liquidation process.

We would also note that the credit balance figure Ovo Energy is seeking our consent to claim for includes a number of accounts where the final account/credit balance position is not yet confirmed. We would expect Ovo Energy to have provided final, agreed amounts in time for our final decision (and if not, our decision may be conditional upon future adjustment to the claim amount, once the actual figure is known).

Recovery of LRSP claim

Electricity distribution network operators have 3 months from the receipt of a valid LRSP claim to commence making payments and a further period of 12 months in which to complete making payment. Depending on the timescale for us making a decision, the amount we consent to may be recovered from relevant gas distribution networks in 2020/21.

Next steps

The purpose of this letter is to provide interested parties with an opportunity to make any representations to us, ahead of us making our final decision.

⁷ Precisely £13,080,509

⁸ See note 2.

We invite any representations by **15 January 2020**. Responses should be emailed to supplier@ofgem.gov.uk.⁹

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, in reaching our final decision on Ovo Energy's claim. We currently expect to confirm our decision in January 2020, in time to enable the approved claims to be recovered from relevant gas and electricity distribution network companies in 2020/21.

Yours faithfully,

Philippa Pickford

Director, Future Retail Markets, Consumers and Markets

⁹ Although we prefer responses in electronic format, responses can be posted to the address below.