

## All interested parties

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Date: 17 December 2020

Dear colleague

### Appointment of ScottishPower as Supplier of Last Resort

On 9 October 2020, we announced<sup>1</sup> that we had appointed ScottishPower Energy Retail Limited (“**ScottishPower**”) as the new supplier for Tonik Energy Limited’s (“**Tonik**”) gas and electricity customers and issued our decision to revoke Tonik’s gas and electricity licences.<sup>2</sup> This followed our earlier announcement that Tonik had ceased trading.<sup>3</sup>

We appointed ScottishPower as the Supplier of Last Resort (“**SoLR**”) for Tonik’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 Tonik and all consumers. This letter summarises the background to this process, and the reasons<sup>4</sup> for our decision<sup>5</sup> to appoint ScottishPower.<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

The number of suppliers in the retail energy market has increased significantly over the last eight years. The market share of the largest suppliers has decreased and now almost 30% of customers get their energy from small and medium suppliers. This has brought benefits to consumers through increased price competition and pressure on incumbent suppliers to improve their customer service. However, as in any competitive market, suppliers can sometimes fail.

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<sup>1</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-appoints-scottish-power-take-customers-tonik-energy-ltd>.

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

<sup>3</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-protects-customers-failed-supplier-tonik-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/direction-appoint-scottishpower-energy-retail-limited-electricity-supplier-last-resort-0> and <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-scottishpower-energy-retail-limited-gas-supplier-last-resort-0>.

<sup>6</sup> The obligation for a supplier (such as ScottishPower) 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 ScottishPower’s obligations to supply Tonik’s former 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>.

Energy is an essential service. As such, when a supplier fails, our priority is to ensure its customers have continuity of supply. We also want to make sure that supplier failures do not undermine confidence in the competitive market. Furthermore, we aim to minimise wider market disruption, which can occur if the failed supplier has debts that need to be mutualised across other industry parties.

Our general preference when a supplier is exiting the market is for a commercial solution to be found. However, where this is not possible, and where regulatory intervention is required, we step in by running a competitive process (the SoLR process) to appoint a new supplier for customers of the failed supplier. This process ensures continuity of supply and protects the credit balances of the failed supplier's customers.

We can direct any licensee to be a SoLR.<sup>8</sup> However, to ensure we appoint the company we think is best placed to protect customers of a failing supplier, we ask companies interested in being the SoLR to provide us with certain key information. This includes: how they expect to on-board the new customers; the extent to which they expect to make a claim to recover costs via the industry levy; whether they have the capability to supply the increased volumes of electricity and gas; how they will maintain customer service standards and treat customer credit balances; and information about the tariff they will put the customers on. Where possible, we also seek to appoint a company that has volunteered to act as a SoLR.

Further information on the criteria that we apply in selecting a suitable SoLR is contained in our published SoLR guidance.<sup>9</sup>

### **Background to this decision**

In September 2020, Tonik confirmed to us that it was in severe financial difficulty, 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, we undertook the following steps leading up to the decision we announced on 9 October 2020:

- We sought information from Tonik on their customer base and arrangements for supply, for the purposes of running the SoLR process
- We sent information requests<sup>10</sup> to all licensed gas and electricity suppliers who had expressed an interest in being appointed as a SoLR,<sup>11</sup> asking them to explain how they would manage being appointed as a SoLR for Tonik's customers. 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>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> Ofgem, [Supplier of Last Resort: Revised Guidance 2016](#), October 2016.

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

<sup>11</sup> We also require the largest energy suppliers to provide this information in accordance with condition 5 of the Standard Licence Conditions for gas and electricity supply, regardless of whether they have expressed an interest in acting as a SoLR. This is because Ofgem may appoint a licensed energy supplier to act as a SoLR whether or not they consent to that appointment.

<sup>12</sup> Elexon for electricity, Xoserve for gas and the Data Communications Company for enrolled smart meters.

## **Our decision**

On 9 October 2020, we announced our decision to appoint ScottishPower as the SoLR, in order to ensure continuity of supplies of gas and electricity to Tonik's customers, and payment of appropriate charges under the industry arrangements. We also gave notice of our decision to revoke Tonik's supply licences.<sup>13</sup>

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 nine 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 ScottishPower's proposal was the best deal for customers.

### *Volunteers for the role of SoLR*

As set out in our SoLR guidance,<sup>14</sup> our preference is given to suppliers who volunteer to undertake the role of SoLR. Of the submissions we received, a majority, including ScottishPower, 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>15</sup> We recognise that a key concern for customers of Tonik (both existing and past customers who may still have been owed money by Tonik) would be whether their credit balances would be honoured. Indeed after ensuring continuity of supply, protecting consumers' money (both existing and past customers), was one of the most important factors in our decision.

Of the submissions we received from suppliers, a majority, including ScottishPower, confirmed they would honour the credit balances for Tonik's customers. Given the implications for overall consumer confidence, as noted above, we also considered whether suppliers would honour the credit balances of former Tonik customers who had switched away but were still due a credit refund. A majority, including ScottishPower, 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 where Ofgem gives its consent.<sup>16</sup>

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<sup>13</sup> Revocation of the supply licence is necessary for the SoLR arrangements to come into effect. The notices to revoke Tonik's licences are published on our website, see the links in footnote 2. The licence revocations and LRSDs are effective as of 10 October 2020.

<sup>14</sup> See paragraphs 3.2 to 3.4 of our SoLR guidance.

<sup>15</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>16</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.

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>17</sup>

Suppliers indicated a range of approaches to making potential industry levy claims. A majority 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. Some of these suppliers stated their intention to use the levy to cover a range of additional costs they expected to incur if appointed as SoLR. ScottishPower stated it would absorb costs for honouring credit balances and a range of additional costs it expected to incur, up to a specified amount based on information available at the time. ScottishPower reserved the right to make a levy claim but indicated they would only do so where they encountered significant changes or unforeseen events from information available at the time.

### *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>18</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 annual bill figure. We took the prices being charged into consideration as part of the deal for customers, with a general preference to minimise additional charges that consumers might face, provided that the prices were not contingent on recovery of expected supply costs from the levy. Suppliers put forward a range of deemed tariffs. Some suppliers offered deemed tariffs at the level of the current price cap. Whilst others, including ScottishPower, offered more competitive tariffs beneath the price cap and below their Standard Variable Tariff.

### *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>19</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 for onboarding Toniks's customers and we closely assessed each of these. In its submission ScottishPower provided a sufficient level of reassurance regarding continuity such that, along with other relevant factors we considered in the SoLR process, we concluded its appointment was in the best interests of customers.

In light of our appointment decision, we expect ScottishPower to provide the level of service that both existing, and Tonik customers, should expect to receive. To that end, it has agreed to targets covering key customer service metrics and we will closely monitor its performance against these. We will engage closely with ScottishPower and hold them to task should there be any failings. As is always the case in these situations, we reserve the right to escalate our engagement and oversight of a SoLR if we consider it necessary to protect consumers.

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<sup>17</sup> See paragraphs 3.5 to 3.7 of our SoLR guidance.

<sup>18</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>19</sup> See paragraphs 3.14 to 3.22 of our SoLR guidance.

### *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 – ie 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 Tonik's customers.

We considered that ScottishPower provided a sufficient explanation of its capacity and capability to manage the purchasing requirements relating to Tonik's customers. In addition, ScottishPower have a history of adequate compliance with industry code requirements for gas transportation, 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 ScottishPower to be appointed the SoLR for Tonik's customers.

Yours faithfully,

**Lesley Nugent**  
**Deputy Director, Licensing Frameworks**

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

## Annex 1: Summary of SoLR selection criteria

In our SoLR guidance, we set out the selection criteria we will use to determine which supplier to appoint as the SoLR. This annex sets out the categories of questions asked of suppliers to gather the necessary information for us to consider in making the decision to appoint a Supplier of Last Resort.

### 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 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>21</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
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)

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<sup>21</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.