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for energy consumers

All interested parties

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Dear colleague

Appointment of Octopus Energy Limited as Supplier of Last Resort

On 31 July 2018, we announced that we had appointed Octopus Energy Limited as the new supplier for Iresa Limited's gas and electricity customers and our decision to revoke Iresa Limited's gas and electricity licences¹, following an earlier announcement that Iresa Limited had ceased trading.²

We appointed Octopus Energy Limited as the Supplier of Last Resort ("SoLR") for Iresa Limited's customers because their offer represented the best deal for customers. This letter summarises the background to this process, and the reasons³ for our decision⁴ to appoint Octopus Energy Limited.⁵ 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.⁶

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.

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, in practice, until the failed supplier's contracts have been transferred, or deemed contracts are

¹ <https://www.ofgem.gov.uk/publications-and-updates/ofgem-appoints-octopus-energy-take-iresa-s-customers> ; <https://www.ofgem.gov.uk/publications-and-updates/iresa-limited-notice-revocation-gas-supply-licence>, and <https://www.ofgem.gov.uk/publications-and-updates/iresa-limited-notice-revocation-electricity-supply-licence>

² <https://www.ofgem.gov.uk/publications-and-updates/ofgem-protects-iresa-customers-supplies-and-credit-balances>

³ 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.

⁴ <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-octopus-energy-limited-gas-supplier-last-resort>; and <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-octopus-energy-limited-electricity-supplier-last-resort>

⁵ The obligation for a supplier (such as Octopus Energy Limited) 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 Octopus Energy Limited's obligations to supply Iresa Ltd's customers.

⁶ <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>

established with a SoLR, there would be no practical way to prevent an existing customer from taking electricity or gas from the network. This will cause the network system operator to step in to perform a residual role of balancing the gas and electricity in the network. As the failed supplier will not be able to pay for the energy required to balance the networks in this way, these costs will fall to be mutualised across other industry participants. 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.⁷ 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 July 2018, Iresa Limited 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 guidance⁸, we undertook the following steps leading up to the decision we announced on 31 July 2018:

- We sought information from Iresa Limited on their customer base and arrangements for supply, for the purposes of running the SoLR process;
- We sent information requests⁹ 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 bodies¹⁰.

Our decision

On 31 July 2018 we announced our decision to appoint Octopus Energy Limited as the SoLR, in order to ensure continuity of supplies of gas and electricity to Iresa Limited's customers, and payment of appropriate charges under the industry arrangements.

We also gave notice of our decision to revoke Iresa Limited's licences.¹¹

⁷ The obligation for a supplier to comply with a 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).

⁸ https://www.ofgem.gov.uk/system/files/docs/2016/10/solr_revised_guidance_final_21-10-2016.pdf

⁹ In accordance with condition 5 of the Standard Licence Conditions for gas and electricity supply.

¹⁰ Elxon for electricity, Xoserve for gas.

¹¹ Revocation of the supply licence is necessary for the SoLR arrangements to come into effect. The notices to revoke Iresa Limited's licences are published on our website: <https://www.ofgem.gov.uk/publications-and-updates/iresa-limited-notice-revocation-gas-supply-licence> and <https://www.ofgem.gov.uk/publications-and-updates/iresa-limited-notice-revocation-electricity-supply-licence>. The licence revocations and LRSDs are effective as of 1 August 2018.

Reasons for our decision

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 14 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 Octopus Energy Limited's proposal was the best deal for customers.

Volunteers for the role of SoLR

As set out in our SoLR guidance,¹² our preference is given to suppliers who volunteer to undertake the role of SoLR. Of the submissions we received, the majority (8) – including Octopus Energy Limited – 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.¹³ We recognise that a key concern for customers of Iresa Limited (both existing and past customers who may still have been owed money by Iresa Limited) would be whether their credit balances would be honoured. Indeed after ensuring safe continuity of supply, protecting consumers' money (existing and past customers), was one of the most important factors in our decision.

Of the submissions we received from suppliers, the majority – including Octopus Energy Limited – confirmed they would honour the credit balances for Iresa Limited's customers.

Given the implications for overall consumer confidence, as noted above we also considered whether suppliers would honour the credit balances of former Iresa Limited customers who had switched but were still due a credit refund. A minority of suppliers – including Octopus Energy Limited – 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 we give our consent¹⁴; this includes open credit balances but, on the drafting of the current licence condition, not closed balances¹⁵. Our SoLR guidance states

¹² See paragraphs 3.2 to 3.4 of our SoLR guidance.

¹³ 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> .

¹⁴ 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.

¹⁵ We are currently consulting on changes to the relevant licence conditions, to clarify that a SoLR could (if appropriate) seek to recover the costs of protecting all affected customer credit balances – both balances held by the failed supplier's existing customers and balances not yet reimbursed to its former customers. See here for further information: <https://www.ofgem.gov.uk/publications-and-updates/proposed-modifications-solr-supply-licence-conditions>

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.¹⁶

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 open credit balances through the levy. 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, other than the costs of honouring open credit balances. Our considerations in this area took into account the proportion of credit balances that would be recovered through the levy and the amount of total costs that suppliers would seek to recover through the levy.

Price

Our SoLR guidance states that the deemed tariff which the customers of the failed supplier move to 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.¹⁷ 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 (including any offer to honour existing tariffs) were not contingent on recovery of expected supply costs from the levy. Octopus Energy Limited offered to move Iresa Limited's customers onto its "Flexible Octopus" tariff, which was substantially lower than the prices offered by other suppliers.

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.¹⁸ 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" Iresa Ltd's customers; we closely assessed each of these. We were satisfied that the specific arrangements Octopus Energy Limited proposed to put in place to handle these customers were likely to provide satisfactory levels of customer service.

We also gave due consideration to all the information available to us on customer service issues experienced by bidders. We were satisfied that Octopus Energy Limited had adequate processes and systems in place to ensure it meets its obligations. In light of our appointment decision, we expect Octopus Energy Limited to provide the level of service that its customers should expect to receive and we will engage with the supplier closely on its performance levels in this area.

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

¹⁶ See paragraphs 3.5 to 3.7 of our SoLR guidance.

¹⁷ 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.

¹⁸ See paragraphs 3.14 to 3.22 of our SoLR guidance.

their existing customers.¹⁹ 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 Iresa Limited’s customers.

We considered that Octopus Energy Limited provided a sufficient explanation of its capacity and capability to manage the purchasing requirements relating to Iresa Limited’s customers. In addition, Octopus Energy Limited 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 Octopus Energy Limited to be appointed the SoLR for Iresa Limited’s customers.

Yours faithfully,

Rob Salter-Church
Interim Executive Director, Consumers and Markets

¹⁹ 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 ex-gratia payments to **former customers** of the failing supplier with a closed credit account balance²⁰
 - 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 claim²¹
 - 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. The 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 customer's 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.

²⁰ Given the implications for overall consumer confidence, we also asked suppliers whether they would honour the credit balances of former Iresa Limited's customers who had switched but were still due a credit refund

²¹ 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

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).