



Making a positive difference
for energy consumers

All interested parties

Direct Dial: 020 3263 9954
Email: supplier@ofgem.gov.uk

Date: 17 January 2019

Dear colleague

Appointment of Scottish Power Limited as Supplier of Last Resort

On 24 November 2018, we announced that we had appointed Scottish Power Limited (hereafter "**Scottish Power**") as the new supplier for Extra Energy Supply Limited's (hereafter "**Extra Energy**") gas and electricity customers¹ and issued our decision to revoke Extra Energy's gas and electricity licences², following an earlier announcement that Extra Energy had ceased trading.³

We appointed Scottish Power as the Supplier of Last Resort ("**SoLR**") for Extra 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 Extra Energy and all energy consumers. This letter summarises the background to this process and the reasons⁴ for our decision⁵ to appoint Scottish Power.⁶ 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.⁷

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

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

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

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

⁴ 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

⁵ <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-scottishpower-energy-retail-limited-electricity-supplier-last-resort> and <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-scottishpower-energy-retail-limited-gas-supplier-last-resort>

⁶ The obligation for a supplier (such as Scottish power 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 First Utility Limited's obligations to supply Usio Energy Supply Limited's customers

⁷ <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>

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 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.⁸ 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 November 2018, Extra 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 guidance⁹, we undertook the following steps leading up to the decision we announced on 24 November 2018:

- We sought information from Extra Energy on their customer base and arrangements for supply, for the purposes of running the SoLR process;
- We sent information requests¹⁰ 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.¹¹

Our decision

On 24 November 2018 we announced our decision to appoint Scottish Power as the SoLR, in order to ensure continuity of supplies of gas and electricity to Extra Energy's customers, and payment of appropriate charges under the industry arrangements. We also gave notice of our decision to revoke Extra Energy's licences.¹²

⁸ 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)

⁹ https://www.ofgem.gov.uk/system/files/docs/2016/10/solr_revised_guidance_final_21-10-2016.pdf

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

¹¹ Elexon for electricity, Xoserve for gas

¹² 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/extra-energy-supply-limited-notice-revocation-gas-supply-licence> and <https://www.ofgem.gov.uk/publications-and-updates/extra-energy-supply-limited-notice-revocation-electricity-supply-licence>

The licence revocations and LRSDs are effective as of 27 November 2018

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 eight 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 Scottish Power's proposal was the best deal for customers.

Volunteers for the role of SoLR

As set out in our SoLR guidance,¹³ our preference is given to suppliers who volunteer to undertake the role of SoLR. Of the submissions we received, the minority – including Scottish Power – 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.¹⁴ We recognise that a key concern for customers of Extra Energy (both existing and past customers who may still have been owed money by Extra Energy) 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 Scottish Power – confirmed they would honour the credit balances for Extra Energy's domestic customers. Given the implications for overall consumer confidence, as noted above we also considered whether suppliers would honour the credit balances of former Extra Energy customers who had switched but were still due a credit refund. Four suppliers – including Scottish Power – confirmed they would honour these credit refunds. Scottish Power also volunteered to honour the credit balances of Extra Energy's non-domestic customers.

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 we give our consent¹⁵.

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.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 credit balances through the levy. Most suppliers intended to use the levy to cover all of the costs of honouring credit

¹³ See paragraphs 3.2 to 3.4 of our SoLR guidance.

¹⁴ 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>

¹⁵ 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

¹⁶ See paragraphs 3.5 to 3.7 of our SoLR guidance

balances, with a minority offering to contribute to these costs. Scottish Power proposed to make a substantial contribution toward covering credit balances, thereby claiming the least through the levy overall and minimising costs to all consumers.

The majority of 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. Scottish Power's bid identified the fewest costs in this regard, as compared to others'.

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, for the domestic tariffs. 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. Scottish Power offered to move Extra Energy's domestic customers onto a tariff that was comparable to other bids received and cheaper than their standard variable tariff. Scottish Power's non-domestic tariff was cheaper than the majority of bids.

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 "onboard" Extra Energy's customers, and we closely assessed each of these. Scottish Power provided a strong bid that included assurances on getting in touch with customers in a timely way.

In light of our appointment decision, we expect Scottish Power 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 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;

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

¹⁹ See paragraphs 3.8 to 3.13 of our SoLR guidance

- 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 Extra Energy’s customers.

We considered that Scottish Power provided a sufficient explanation of its capacity and capability to manage the purchasing requirements relating to Extra Energy’s customers. In addition, Scottish Power 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 Scottish Power to be appointed the SoLR for Extra 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 guidance²⁰.

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 claim²¹
 - e. suppliers who minimise the extent of price increases – if any – for the customers of the failing supplier

²⁰ Ofgem, [Supplier of Last Resort: Revised Guidance 2016](#), October 2016

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

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 prepayment meter customers will be dealt with
 - f. how customers will be made aware of their options to sign up to a contract with the Licensee or another supplier
 - g. 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).