

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

Email: Philippa.Pickford@ofgem.gov.uk

Date: 28 June 2019

Dear colleague,

Last Resort Supplier Payment Claim from Together Energy Limited

On 31 January 2019, Together Energy Limited ('Together Energy') gave notice to Ofgem of their intention to submit a claim for a Last Resort Supply Payment ('LRSP'). Together Energy is seeking to claim for costs incurred in acting as Supplier of Last Resort ('SoLR') to customers of the former OneSelect Limited ('OneSelect').

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 Together Energy included its calculation of the claim amount and information to support the claim (outlined in Table 1).

This letter sets out the reasons why we are minded to consent to Together Energy claiming a LRSP of up to £4.8m.¹ We are minded to allow Together Energy to claim for the costs of protecting the credit balances owed by OneSelect to the customers Together Energy acquired, in line with commitments given at the time of the SoLR appointment, and certain other costs incurred as part of undertaking the role of a SoLR. In some areas, as noted below, these costs have changed since the submission. We have reviewed these costs carefully and consider that there are circumstances that justify these differences, however we are particularly seeking the views of respondents on these costs as well as on the claim more generally.

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 August 2019, to enable the agreed amount to be recovered through relevant network charges in the period 2019/20 for electricity² and 2020/21 for gas³.

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

¹ The total minded-to claim amount is £4,803,430.

² Under new arrangements, which take effect from 28 June 2019, relevant electricity network companies will commence paying a valid LRSP claim three months after it has been received and to complete payment in a further 12 months - <https://www.ofgem.gov.uk/publications-and-updates/decision-modifications-electricity-distribution-licence-recover-costs-associated-appointing-supplier-last-resort>.

³ Payment of a valid LRSP claim by the gas distribution network operators will be in the 2020/21 charging year.

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 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 a real risk that if a supplier fails without urgent intervention, consumer trust and confidence in the energy market could 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.⁴

OneSelect SoLR event

On 13 December 2018, we appointed Together Energy as the SoLR⁵ for OneSelect's gas and electricity customers following OneSelect's 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 OneSelect's failure, we received six 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 Together Energy as the SoLR in our decision letter published on 25 March 2019.⁶

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 it incurs in complying with a Last Resort Supply Direction (LRSD).

As part of their competitive bid to become a SoLR, a supplier will include whether they expect to make a claim for a LRSP, or whether it will waive this right, in whole or in part. 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 through a LRSP.

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.

⁴ The obligation for a supplier (such as Together 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 Together Energy's obligations to supply OneSelect's former customers.

⁵ <https://www.ofgem.gov.uk/publications-and-updates/ofgem-appoints-together-energy-take-customers-oneselect>

⁶ <https://www.ofgem.gov.uk/ofgem-publications/149609>

Together Energy indicated at the time of our SoLR appointment process that it would not waive its right to make a claim. Together Energy’s claim consists of the following elements:

Table 1: Together Energy SoLR Levy Claim

Item	Cost Category associated with SoLR	Cost claimed by Together Energy (£)
1	Recovery of 63% of OneSelect customers’ net credit balances	3,288,604
2	Wholesale energy emergency purchase	21,381
3	IT migration, data cleansing and billing	776,544
4	Interest on LRSD payment profile	716,901
Total		4,803,430

The cost of protecting customers’ credit balances has been partly (37%) funded by Together Energy.

Our decision process and methodology

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

- A quantitative check of Together 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 Together Energy and ensuring these costs were in line with commitments Together Energy made at the time of its SoLR appointment
- Validation of assumptions with other data sources, where appropriate
- A qualitative assessment of each claim item 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 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 the specific circumstances of this levy claim case and taking into consideration all information available to us, we are minded to consent to Together Energy claiming a LRSP of up to £3.3m⁷ in respect of the amount they have incurred to honour credit balances for former OneSelect customers. We also think it is appropriate to enable Together Energy to recover certain other costs of up to £1.5m⁸ and are particularly seeking stakeholders' views on these costs. Our position would enable Together Energy to recover up to this amount through relevant network charges in the period 2019/2021. This is subject to the removal of 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

Cost item 1: Recovery of 63% of OneSelect customers' net credit balances (£3.3m)

Our published guidance states that we may in certain circumstances 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 (subject to the points discussed below) that the claimed amount is consistent with the relevant criteria and in particular, is consistent with Together Energy's commitment in its SoLR bid.

We have considered whether the costs Together Energy is seeking to claim for credit balances are otherwise unrecoverable; it may still be the case that Together Energy is able to recover some of this claimed amount through the ongoing administration process for OneSelect. The current licence provisions related to LRSPs do not require us to make our decision on Together Energy's claim ahead of the conclusion of the liquidation process. However, in our view delaying a decision until the conclusion of the liquidation process would introduce a disproportionate degree of uncertainty around the timing of any approved LRSP claim, and ultimately increase the future costs liable to be paid by energy suppliers and consumers. Given this, we are minded to approve this element of the claim, subject to the outcome of the OneSelect liquidation process. At this point, the final amount Together Energy can claim for credit balances would be adjusted to remove any sums recovered through the liquidation process.

We also note that the credit balance figure Together Energy is seeking our consent to claim includes £763k⁹ by way of provision for credit balances due to former customers ("closed accounts") of OneSelect. Together Energy has to date paid approximately £170k in closed account balances, which it says reflects a low-take up of requests by these customers to provide the banking details necessary to make payment via a secure portal. Together Energy is taking further steps to contact relevant customers and is reporting to Ofgem on progress in this area.

The credit balances of former OneSelect customers who have remained with Together Energy are now largely resolved, with most of these customers having been issued with final bills (for energy consumed to Together Energy's appointment as the SoLR) and where appropriate a credit has been applied to their account. A number of outstanding

⁷ Precisely £3,288,604

⁸ Up to £1,512,926

⁹ Precisely £762,649

accounts remain to be resolved, and we expect Together Energy to take all reasonable steps to conclude this process as soon as is reasonably practicable.

Whilst we are minded to consent in principle to the amount claimed for credit balances, we would expect Together Energy to have provided final, agreed amounts as regards both closed and open credit balances in time for our final decision and if not, our decision will be conditional upon future adjustment to the claim amount, once the cost of credit balances is finalised.

The overall cost of the claim for credit balances could also change depending on the final value realised by Together Energy from OneSelect's customer debt book. As with the position on the OneSelect liquidation process, the final amount Together Energy can recover would be reduced to include the value of debt recovered from former OneSelect customers, net of costs.

Cost item 2: Wholesale emergency purchase (£21k)

The claim for wholesale electricity costs is for £21k¹⁰ and represents the additional costs of purchasing electricity in the period 14 – 21 December 2018 over and above the wholesale energy purchasing arrangements which Together Energy had in place to meet the demands of its existing customer base. Together Energy has not submitted a claim for the cost of wholesale gas purchases.

We have reviewed the information submitted by Together Energy in relation to the purchase of energy and are minded-to agree that the methodology used to calculate this element of Together Energy's claim is appropriate. We note that in making the SoLR bid Together Energy estimated the cost of wholesale energy purchases to be potentially higher than this amount, and so this element of the claim is lower than Together Energy initially indicated may be the case.

Cost item 3: IT migration, data cleansing and billing (£777k)

This item relates to the costs incurred in transitioning OneSelect's customers to Together Energy, where these costs arose directly as a result of the SoLR process.

In its SoLR bid Together Energy set out its intention to claim £700k for non-credit balance costs (ie the cost of wholesale energy and IT migration, data cleansing and billing). Together Energy say that a key driver for the higher cost under this item is the work undertaken to establish a process and system to verify customer accounts and credit/debit positions, to migrate these details to Together Energy's systems and to support customers during the transition from OneSelect. Together Energy also say in making the bid it understood OneSelect's administrator would cover the cost of maintaining the licence used by OneSelect for access to its billing system. Together Energy took the view that access to the billing system was crucial to maintain continuity and assist with historic investigation and incurred the cost of the licence fee for that access. Together also incurred additional costs related to collecting bank details of customers, and contact details of some customers.

We note that the costs claimed under this item are higher than estimated in the SoLR bid but are minded-to agree that the approach taken by Together Energy was appropriate¹¹. We understand it was aimed at ensuring customers were not disadvantaged, while at the same time seeking to minimise costs claimed through the levy by seeking, as far as possible in the circumstances, to verify actual account positions and to provide customer support during the transition to Together Energy.

¹⁰ Precisely £21,381.

¹¹ We consider that a small element of this cost item, amounting to £1.9k for certain project related costs, is the type of expenditure we would expect a SOLR supplier to absorb and have deducted this from the sum we are minded to approve.

Cost item 4: Interest on LRSP profile costs (£717k)

Together Energy has made a claim of £717k for the cost of interest on the working capital used to finance the activities carried out under its role as a SoLR, in advance of the repayment of the approved LRSP claim by relevant gas and electricity network companies. In its SoLR bid Together Energy explained that it expected to claim a potentially lower amount for the cost of interest on working capital. Together Energy says that this reflected its assessment of the market at the time and that conditions have changed. The amount Together Energy is now seeking to claim reflects the interest rate they have been offered to secure borrowing based on current market conditions.

The total amount claimed in interest partly reflects the timescale over which the approved claim will be recovered from gas and electricity network charges. Recent changes to the electricity distribution licence¹² will enable Together Energy to begin to recover the sum we consent to from electricity network companies within 3 months of Together Energy presenting a valid LRSP claim, and for the payment of the relevant amount to be completed with a further 12 months. However, these arrangements apply only to electricity. The amount we consent to be recovered from relevant gas network charges will be paid by relevant gas distribution network companies in charging year 2020/21.

We recognise that not all of the assumptions on which a SoLR bid is made are wholly within the control of the supplier and that circumstances can change. Nevertheless, the integrity of the tender process requires the appointed SoLR to make all reasonable efforts to control and to keep costs, as far as is practicable, in line with the SoLR bid. In this case, we recognise that while Together Energy has a degree of flexibility to negotiate potential finance deals, in practice the number of offers and the rates of interest are outside of its control. We are, therefore, broadly sympathetic to the claim for interest but would welcome views from stakeholders.

Any final sum we consent to for the LRSP would be adjusted to take account of the actual cost of interest on working capital incurred by Together Energy, and would need to be supported by evidence that the cost of borrowing was consistent with the need to minimise the cost to consumers.

Summary

We are minded to consent to Together Energy claim a LRSP of up to £3.3m¹³ for the cost of credit balances and wholesale energy purchases and to consider consenting to up to £1.5m¹⁴ for other costs, in the light of responses to this consultation.

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. We invite any representations by **26 July 2019**. Responses should be emailed to supplier@ofgem.gov.uk.¹⁵

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.

¹² <https://www.ofgem.gov.uk/publications-and-updates/decision-modifications-electricity-distribution-licence-recover-costs-associated-appointing-supplier-last-resort>

¹³ Precisely £3,309,985

¹⁴ Up to £1,491,545

¹⁵ Although we prefer responses in electronic format, responses can be posted to the address below.

We will take into account all relevant information, including any representations we receive, in reaching our final decision on Together Energy's claim. We currently expect to confirm our final decision in August 2019, to enable the approved claim to be recovered from relevant electricity network charges in 2019/2020¹⁶ and from relevant gas network charges in 2020/21.

Yours faithfully,

Philippa Pickford

Director, Future Retail Markets, Consumers and Markets

¹⁶ Following recent changes to the electricity distribution licence, which come into effect on 28 June 2019, DNOs will commence paying a valid LRSP claim within three months after it has been received.