

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

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Dear colleague,

Decision on Last Resort Supply Payment claim from Ovo (S) Gas Limited

On 5 November, Ovo (S) Gas Limited¹ ("Ovo") gave notice to Ofgem of their intention to submit a claim for a Last Resort Supply Payment ("LRSP") of £45k² for costs³ incurred in acting as Supplier of Last Resort ("SoLR").

The LRSP claim is in respect of former domestic gas customers of Cardiff Energy Supply Limited ("Cardiff 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 claimed⁴. This letter sets out our⁵ decision to consent to the claim from Ovo for a LRSP of up to £45k⁶.

Our decision will allow Ovo to recover from relevant gas distribution networks the costs of protecting the credit balances owed to former customers of Cardiff Energy, and certain other costs incurred as part of complying with the terms of the Last Resort Supply Direction ("LRSD")⁷.

In taking this decision, we have had due regard to Ofgem's principal objective of protecting the interests of current and future energy consumers, the relevant provisions of the Ovo (S) gas supply licences, Ofgem's "Guidance on supplier of last resort and energy supply company administration orders" (our "Guidance")⁸, the terms of the LRSD and the particular circumstances of compliance with the LRSD.

Background

The SoLR process

¹ Company number 02716495

² £45,015

³ The claim is in respect of costs incurred by Ovo (S) Gas Limited in complying with the terms of the relevant Last Resort Supply Direction.

⁴ In accordance with Standard Condition 9 of the electricity and gas supply licences.

⁵ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day-to-day work. This decision is made by or on behalf of GEMA.

⁶ Exactly £45,015

⁷ [Direction to appoint Southern Electric Gas Limited as Gas Supplier of Last Resort](#)

⁸ [Supplier of Last Resort: Revised Guidance 2016](#)

Electricity and gas supply is a competitive activity in Great Britain. Competition has the potential to bring many benefits to consumers but 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 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.⁹

Cardiff Energy SoLR event

In August 2019, Cardiff 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.

Appointment of SoLR

We announced on 7 August 2019 our decision¹⁰ to appoint Southern Electric Gas Limited, now Ovo (S) Gas Limited, as the SoLR for Cardiff Energy's gas customers. The Authority decided not to request expressions of interest from suppliers to act as the SoLR in this case given the small number of customers supplied by Cardiff Energy (approximately 800 domestic gas customers) and because Southern Electric Gas Limited (now Ovo (S) Gas Limited) had recently been appointed as SoLR for the former customers of Brilliant Energy through a competitive process, during which the Authority sought expressions of interest from energy suppliers that had expressed an interest in volunteering as a potential SoLR.

We took the decision to appoint Ovo (S) Gas Limited to act as the SoLR for Cardiff's customers in light of the Authority's principal objective to protect the interests of consumers, particularly because the licensee agreed to offer the same protections to Cardiff's customers as had been provided to Brilliant Energy's former customers. In these circumstances, the Authority considered that it would be disproportionate to conduct a further competitive selection process for a small number of customers.

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)¹¹. As part of their competitive bid to become a SoLR, a supplier will

⁹ The obligation for a supplier 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's obligation to supply Cardiff Energy's former customers.

¹⁰ [Direction to appoint Southern Electric Gas Limited as Gas Supplier of Last Resort](#)

¹¹ Standard condition 9 of the electricity and gas supply licences.

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 published 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 guidance¹², 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. It stated that it would make a claim for the cost of credit balances and other costs incurred in acting as a SoLR. The claim from Ovo includes its calculation of the claim amount and information to support the claim as outlined in Table 1 below.

Table 1: OVO LRSP claim

Item	Cost Category associated with SoLR	Cost claimed by Ovo (£)
1	Recovery of customer credit balances	16,161
2	Operational costs	26,878
3	Cost of Capital	1,976
	Total costs	45,015

Cost item 1: Credit balances

Ovo’s claim is for the cost to refund credit balances to existing and former (closed account) domestic gas customers of Cardiff Energy. 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.

Cost item 2: Operational costs

Ovo’s claim is for costs incurred in managing and carrying out the on-boarding of ex-customers of Cardiff Energy, including addressing data quality issues, reconciling meter reading and data, SoLR customer communications, dealing with customer enquiries, assisting the administrator with calculation of final bills and migration of customer data to Ovo’s system.

Cost item 3: Cost of capital

¹² [Supplier of Last Resort: Revised Guidance 2016](#)

Ovo's claim includes interest on the cost of capital in respect of the costs incurred in relation to its appointment as SoLR for Cardiff Energy.

Our decision process and methodology

Our process to reach our decision consisted of:

- A quantitative check of the methodology for each cost item claimed. This includes determining how each total cost item was calculated based on data sent to us.
- Ensuring costs are in line with commitments made at the time of the 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 LRSP claims is shown in Annex 1.

Our decision

On balance, taking into consideration all information available to us and the specific circumstances of this case, we have consented to Ovo claiming a Last Resort Supply Payment of up to £45k¹³. We have made this decision in light of the broader market considerations and our wider statutory duties to protect both existing and future consumers. This is subject to any costs recovered from the Cardiff Energy 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 for a LRSP. We have set out below our reasons for our decision in 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.

The current licence provisions related to LRSPs do not require us to make our decision on Ovo'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.

We are satisfied in this case that the claimed amount is consistent with the relevant criteria and with the basis on which Ovo was appointed as SoLR for the customers of Cardiff Energy. We consider that Ovo's claim meets the tests that we apply to LRSP claims including that these costs are additional to the costs that Ovo would face in serving existing customers, were directly incurred as a result of Ovo's SoLR appointment, are otherwise unrecoverable, and were unavoidable.

Given this, we are consenting to Ovo's LRSP claim, subject to the outcome of the Cardiff Energy liquidation process. At that point, the final amount Ovo can claim for credit balances would be adjusted to remove any sums recovered by Ovo through the liquidation process.

Recovery of LRSP

¹³ Exactly £45,015.28

Ovo will be paid the amounts specified in the gas consent published alongside this decision, by the relevant licenced gas network companies. This will be recovered by the relevant gas distribution networks allocated in proportion to the total number of nationwide gas supply points. We consider this apportionment to best enable broad socialisation of the claim costs in line with the intent of the SoLR regime to protect all consumers in the market, for example, through limiting the extent of unpaid industry bills of a failing supplier.

As per the standard conditions of the gas and electricity supply licence regarding LRSP claims, Ovo will be able to submit a claim to each relevant gas distribution network operator, based on the amount we have consented to and each network's share of the total premises served by the relevant networks. We expect Ovo to do this on the basis of the customer numbers contained within the gas network companies' regulatory reporting packs.

Yours faithfully,

Lesley Nugent
Deputy Director, Retail

Annex 1 - Methodology criteria for LRSP claims

- **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.