National Audit Office

The energy supplier market

The Department for Business, Energy & Industrial Strategy and Ofgem

REPORT

by the Comptroller and Auditor General

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National Audit Office

The energy supplier market

The Department for Business, Energy & Industrial Strategy and Ofgem

Report by the Comptroller and Auditor General

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Comptroller and Auditor General
National Audit Office

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Key facts

29

number of energy suppliers that have failed since July 2021

£2.7bn

Ofgem's current best estimate of the cost of transferring customers of failed energy suppliers to new suppliers through the 'supplier of last resort' (SOLR) process and missed payments to support renewable generation, which equates to around £94 per customer. This cost is very uncertain and could go up, or down.

2.4m

total number of customers that have moved to new suppliers through the SOLR process since July 2021

Nearly six-fold	the increase in the weekly average wholesale price of gas that took place between February 2021 and December 2021
78%	increase in the bill for a typical customer purchasing energy at the price cap since its introduction, rising from £1,105 per year in the winter of 2018-19, to £1,971 in the summer of 2022
1.6 million	approximate number of customers of Bulb Energy in November 2021, when it was placed in special administration
£0.9 billion	amount spent on running Bulb Energy through the special administration regime in 2021-22
£1.0 billion	amount budgeted to run Bulb Energy through the special administration regime in 2022-23. The actual cost could be above or below this amount

Summary

Introduction

1 Most households and businesses in Great Britain are supplied with gas and electricity through the energy system. There are four main components of this system: generation; transmission; distribution; and retail. Energy retailers (known as suppliers) purchase gas and electricity from the wholesale market and sell it to homes and businesses. Some energy companies that own and operate energy suppliers also own and operate other elements of the energy system. Suppliers have a potentially important role to play in achieving the government's net zero target by offering products and services that help customers to reduce their energy consumption and supporting optimal use of the energy system to minimise consumer costs.

2 The Department for Business, Energy & Industrial Strategy (the Department) is responsible for setting and developing energy policy in the UK. The Office of Gas and Electricity Markets (Ofgem) regulates gas and electricity markets in Great Britain. Ofgem's principal objective is to protect the interests of existing and future consumers. In doing so it must have regard to factors including the need to secure that licence holders can finance their regulated activities. In performing its duties Ofgem must consider the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes or residing in rural areas.

3 Since the energy market was opened to competition from the 1990s, domestic energy consumers have been free to choose their domestic energy supplier. In the decade after it was opened to competition the energy supplier market consisted of six large energy companies, and a similar number of small suppliers; however, since 2010, smaller companies began to enter the market in greater numbers. The total number of domestic suppliers went from 12 in December 2010 to 23 in May 2022, with a peak of 70 suppliers in mid-2018. By September 2021, the new entrants held around 40% of the market share.

4 In 2019, the Department introduced a price cap on some types of tariff, which Ofgem has been required to operate since. The Department intended that the price cap should ensure that customers pay no more than a fair price for their energy, as determined by Ofgem's analysis of supplier costs. The price paid by a typical customer purchasing energy by direct debit at the price cap will have increased by 78% from £1,105 per year in the winter of 2018-19 to £1,971 in the summer of 2022.

5 Between mid-2021 and spring 2022, the wholesale market price that suppliers paid for gas and electricity increased to unprecedented levels. By December 2021, weekly average wholesale gas prices (to which electricity prices are closely linked) had risen to nearly six-fold the level in February 2021. Partly because of the increase, during the period between July 2021 and May 2022, 29 energy suppliers failed, affecting nearly four million households in the UK.

6 Ofgem and the Department have two main processes for maintaining continuity of supply when a supplier fails: the supplier of last resort (SOLR) process and the special administration regime (SAR)**.** Under the SOLR process, Ofgem transfers customers from a failed supplier to an existing supplier to maintain their continuity of energy supply. In cases where SOLR is not viable, a SAR is where a temporary special administrator continues running the failed company until it can be sold as a going concern, or the customers can be transferred to other suppliers.

7 This report aims to set out the facts regarding the recent exit of energy suppliers and to evaluate Ofgem's and the Department's roles in the events leading to the exits and how well they handled them. It covers:

- the nature and regulation of the energy supplier market (Part One);
- how supplier exits have been handled and what they have cost (Part Two); and
- the regulation of the energy supplier market and how this contributed to the exits (Part Three).

The report does not cover wider issues relating to the supply and price of energy, such as policy considerations relating to the generation of energy, instalment of insulation, or whether and how to reduce the impact of the increase in energy prices on consumers. The report also does not assess the effectiveness of changes to supplier market regulation that Ofgem and the Department are currently introducing.

Key findings

The Department's and Ofgem's handling of supplier exits

8 The Department and Ofgem ensured the four million customers whose supplier failed did not experience an interruption to their supply. Since July 2021, Ofgem has transferred nearly 2.4 million customers of 28 energy suppliers to alternative providers through the SOLR process, without any interruption to their energy supply. The Department and Ofgem had prepared in advance for the collapse of a large energy supplier, which meant they were prepared to put Bulb Energy into special administration in November 2021, ensuring there was no immediate impact on its approximately 1.6 million customers (paragraphs 1.12, 1.13, 2.3, 2.17 and 2.20, and Figure 5).

9 Many customers of failed suppliers have experienced increases in their bills while some have also faced other challenges. Issues which customers experienced included: an immediate increase in their energy costs as they transferred to a higher tariff, which Citizens Advice estimates has cost the average customer £30 more per month for the remainder of the duration of their original contract; uncertainty regarding transfer of protected credit balances from one provider to another; loss of debt repayment plans that help customers struggling to pay debt arrears, which particularly impacts on vulnerable households; and the inability to resolve issues relating to the supplier which had gone into administration (paragraph 2.4 and Figure 6).

The costs of supplier exits

10 The final cost to customers of suppliers that have exited the market is still very uncertain but Ofgem currently estimates it will be around £2.7 billion, which would equate to around £94 per customer. Suppliers who take on the customers of failed suppliers are reimbursed for the resultant costs through the SOLR process. This spreads the cost of exits across all energy bills rather than just the customers of failed suppliers, who also may see an increase in their bills as they are moved to a different tariff. There are several elements to these costs, some of which are very uncertain and could cause the final cost to go up, or down:

- Ofgem has approved claims worth £1.8 billion (around £66 per customer paying for energy at the price cap) for the SOLR of 2.2 million customers from 22 suppliers that failed between September and December 2021, mostly to cover the cost of buying wholesale energy for these customers above the level of the price cap (paragraph 2.8).

- Ofgem expects to approve a further £548 million of related claims under current rules both in relation to additional claims from the 22 suppliers for which it has already approved first claims and the suppliers which failed outside the claim period or had not previously submitted claims. Ofgem is consulting on its approach to reimbursing the additional costs that suppliers who acted as SOLRs faced, to ensure it is fair. The decision will impact the extent to which costs being passed on to customers through the levy will increase and could potentially be significant (paragraphs 2.8 and 2.10).

- Some failed suppliers missed payments into the government's schemes to support renewable generation, which means a further £296 million may be added to customers' bills (paragraph 2.8).

- Ofgem is seeking a court ruling to determine whether it and others, such as SOLRs, can make a claim as a creditor in the administration of a failed supplier. If Ofgem wins its case this could reduce the total cost to customers by up to around £0.5 billion but is likely to be significantly less than this (paragraph 2.11).

- The costs of supplier failure are likely to have been offset by some customers having cheaper bills in previous years because new entrants to the market increased competition. However, the significance of this is uncertain and it is likely that some customers will be disproportionately affected over the whole period, particularly those who were less active in switching between suppliers to obtain cheaper tariffs (paragraph 2.13).

11 The overall costs of supporting Bulb Energy will not be known until it is sold or it exits special administration by other means. During 2021-22 the Department spent £0.9 billion to enable an administrator to run Bulb Energy. The Department will need to continue funding Bulb Energy's operations until it exits administration, either because it is bought by investors or through other means, such as reallocating its customers to one or more other suppliers. HM Treasury has budgeted an additional £1.0 billion to run Bulb Energy during 2022-23. The actual cost is very uncertain partly because, in line with government spending guidance, the Department and HM Treasury chose not to hedge, which means its running costs are affected by the ongoing volatility in wholesale markets. The costs incurred may be offset by proceeds of any sale, although this is subject to what value a potential buyer places on Bulb Energy. The Department has the power to recover the final net cost from bill payers through a levy, at a time of its choosing (paragraphs 2.18 to 2.22).

The regulation of the energy supplier market and how this contributed to the exits

12 By 2021 many suppliers lacked financial resilience to deal with wholesale price increases. An independent review by the consultancy company Oxera commissioned by Ofgem following the 2021 supplier exits found that the business models adopted by many new suppliers exposed them to supply or demand shocks. For example, energy suppliers that failed operated with lower liquidity levels (less access to cash) than their peers and were more reliant on customer credit balances to finance their day-to-day operations. This meant that they were heavily exposed to volatility in the energy market (paragraphs 3.2 and 3.3).

13 Ofgem's approach to licensing and monitoring suppliers increased the risk and cost of supplier failure. Since the market was opened to competition, Ofgem has been keen to encourage new entrants to improve customer choice, ensure competitive prices and encourage innovation. It accepted that some energy suppliers would fail as part of the normal functioning of a competitive market; Ofgem saw its role as minimising the impact and disruption for customers of any failure. Prior to 2019, it operated what it has termed a 'low bar' approach to licensing new suppliers. It did not undertake detailed scrutiny of licence applicants' financial situation nor require commitments of shareholder equity prior to market entry and did not formally refuse any supply licence applications. Ofgem also did not monitor in detail suppliers' financial stability, including the sustainability of their business models. Oxera's review found some suppliers did not have enough "skin in the game" and that there were several regulatory options which Ofgem could have pursued which would have mitigated either the risk or cost of supplier failure (paragraphs 3.4, 3.5 and 3.10).

14 Ofgem began tightening rules to improve suppliers' financial resilience in 2018 but did not introduce changes to address the risks relating to existing suppliers until 2021. In November 2018, following an increase in supplier failures and some inadequate service provision, Ofgem consulted on increasing entry requirements for new energy suppliers and tightening the rules on financial resilience for existing suppliers. In July 2019, Ofgem introduced new assessments of applicants for a supplier licence but did not introduce tighter rules for existing suppliers until January 2021. Ofgem plans to assess the extent to which earlier implementation of its changes would have reduced the risk or cost of supplier failures, or both (paragraphs 3.7 and 3.8).

15 Ofgem did not consider what impact the price cap might have if there was significant volatility or sustained periods of price increases in the wholesale energy markets. When introducing the price cap Ofgem undertook some modelling to understand its potential impact on supplier resilience, primarily in relation to the 'big six'. Although it understood that the price cap could make suppliers – especially small suppliers – more vulnerable to price shocks, it did not stress-test the price cap's design in depth. Nor did it consider how the price cap might interact with the SOLR process. The exact impact of the price cap on the supplier failures is uncertain but it is likely that many suppliers would have failed even without its existence given their lack of financial resilience. However, the cap has affected the market in other ways, such as increasing the costs passed on to customers when suppliers have failed (paragraphs 3.22 to 3.24).

16 The Department has announced plans to enable the price cap to be extended but is yet to evaluate its costs and benefits or consider alternative forms of price cap. The price cap has achieved some benefits for consumers, such as encouraging suppliers to achieve efficiency savings that can be passed on to bills. However, it may also have had some long-term disbenefits, such as reducing competition in the market by limiting the price differentials that suppliers can offer at times of high wholesale prices. Neither the Department nor Ofgem has undertaken a full evaluation of the costs and benefits of the price cap for consumers. In February 2022 Ofgem set out changes it expected to make to the cap to ensure it reflects the underlying costs and risks to energy suppliers of supplying energy to default tariff customers. Ofgem told us that there may be benefits from alternative forms of price cap but that these may require the Department to make legislative changes. In May 2022, the government announced that it intended to bring forward legislation which would include enabling the extension of the price cap beyond 2023 (paragraphs 3.23 and 3.27 to 3.30).

Ofgem's planned changes in relation to the regulation of the energy supplier market

17 Ofgem is exploring changing the licensing regime to prevent shareholders of failed companies making a return at the expense of consumers. On insolvency, administrators of failed suppliers will monetise assets of the company. This could include hedges (contracts to purchase wholesale energy at a fixed price in the future), which potentially hold market value at the point of collapse. When a supplier fails, the value of any hedges remains as an asset of the failed company and is used to pay off creditors, and potentially shareholders. The SOLR then incurs the cost of re-hedging or buying energy at the spot price, which it can then pass on to consumers through the SOLR process. Ofgem is exploring introducing changes to the licensing regime so that hedge values recovered from failed suppliers are used to offset SOLR costs. In its view this may partly help to reduce the cost to consumers of failure and incentivise better stewardship of suppliers as shareholders would be more at risk from failure. Ofgem told us that, in its view, legislative change is also needed to fully protect consumers (paragraph 2.12).

18 Ofgem is tightening the rules for suppliers to improve their financial resilience and seeking new powers and resources to enforce them. In December 2021, Ofgem published an action plan on retail financial resilience setting out plans to strengthen the financial resilience of suppliers and ensure that risks are not passed on inappropriately to customers. It is also seeking additional resources from HM Treasury, and new powers to enable it to take a more proactive approach to monitoring and responding to issues of financial resilience. Some stakeholders told us that Ofgem had previously been slow to react to potential licence breaches and some were concerned that Ofgem was requesting new powers when it had not made full use of its existing ones (paragraphs 3.11, 3.12 and 3.18 to 3.20).

19 There is a risk that Ofgem's changes could hinder both effective competition and the supplier market from contributing to the achievement of net zero. Some of the new suppliers that entered the market offered more innovative products and services that support customers to reduce their energy consumption or make their energy usage more flexible. They also created greater competition on the price of bills. Some stakeholders have warned that Ofgem's reforms to the supplier market could prevent the entry of new suppliers that would offer this price competition and innovation in future if the market returns to more benign conditions. Ofgem is introducing its reforms ahead of further clarity being provided on the role of suppliers in achieving net zero. The Department published its *Energy Retail Market Strategy* in July 2021, setting out its vision for a market that enables net zero. But in December 2021 it announced that this strategy needed revisiting to take account of the supplier failures (paragraphs 1.10, 3.4, 3.15 and 3.17).

Concluding remarks

20 Ofgem could not have prevented the increase in wholesale prices in 2021 from significantly affecting consumers, but it did not do enough in the years that preceded it to ensure the energy supplier sector was resilient to external shocks. By allowing many suppliers to enter the market and operate with weak financial resilience, and by failing to imagine a scenario in which there could be sustained volatility in energy prices, it allowed a market to develop that was vulnerable to large-scale shocks and where the risk largely rested with consumers, who would pick up the costs in the event of failure. Ofgem has operated the SOLR process effectively in that it has ensured households faced no disruption to their supply. But the sheer number of supplier failures means a significant additional cost on every bill at a time when wider cost increases are already causing major financial challenges for many households. Ofgem has rightly recognised that it must quickly improve its capacity to oversee the financial resilience of individual suppliers and the sector as a whole.

21 Ofgem, along with the Department, must also ensure the supplier market recovers from its current state, where high wholesale prices combined with the price cap has stifled some aspects of competition, and where ongoing volatility means many suppliers still face financial risks. But this recovery needs to facilitate a longer-term transition of the supplier market to one that truly works for consumers and supports the achievement of net zero. This is a significant and difficult task, requiring Ofgem and the Department to maintain the capacity to consider the longer-term objectives while managing the short-term challenges of stabilising the market. This will require a nuanced approach to regulation that finds a balance between its aims of competition, innovation, resilience and affordability for consumers.

Recommendations

22 The Department and Ofgem together should:

a in line with plans to revisit the *Energy Retail Market Strategy*, **set a date by which they will review the changes needed to retail market regulation so that the supplier retail market aligns with the achievement of net zero**. They should also establish interim milestones, including establishing by the end of 2022 high-level principles around the role suppliers will play in achieving net zero with which to test whether any short-term financial regulations are compatible with these principles;

b **establish a process by the end of 2022 for considering how new interventions in the retail market, like the price cap, would react in a wide range of scenarios**, to mitigate the risk that interventions implemented at pace do not sufficiently consider the risks and unintended impacts;

c **undertake a review of the costs and benefits of the price cap to inform decisions about the operation of the cap and alternative forms of price protection.** This should include consideration of whether alternative types of price cap, such as one that focuses on vulnerable households or is based on the relative cost of different tariffs a supplier offers, better achieves its objectives for the retail market; and

d **review and update the SOLR process in response to issues which have emerged over the last year.** This includes issues that arose in its implementation, such as uncertainty over credit balances caused by delays in the transfer of customer information, and addressing the imbalance of risk between suppliers and consumers, which currently enables suppliers to exit from the market with little risk and even potentially to make a financial return.

23 Ofgem should:

e **define and agree a set of a set of objectives for its regulation of the retail market against which it should review and report its performance at least annually.** This should be a balanced set of measures based on available qualitative and quantitative information relating to consumer outcomes on issues such as price; quality of service; stability and predictability of tariffs; and delivery of the innovation needed to achieve net zero. This should include input from all the parts of Ofgem that interact with the retail market;

f **build regular review points into its current round of changes to the regulation of suppliers**, including the new financial responsibility principles, for it to consider whether its approach continues to support its range of objectives, including the achievement of net zero and ensuring consumers do not overpay for energy. This should include consideration of whether it is continuing to balance adequately the need for financial resilience and enabling innovative business models to enter the market; and

g as part of its regular reviews, **consider whether it is able to monitor adequately compliance with its new rules around financial responsibility.** This should include considering whether it has sufficient understanding of the business models that suppliers use. It should also consider whether its powers and resources enable it to enforce the new rules and address any issues blocking its ability to take rapid and effective compliance and enforcement action against suppliers where necessary.

Part One

The nature and regulation of the energy supplier market

1.1 This part:

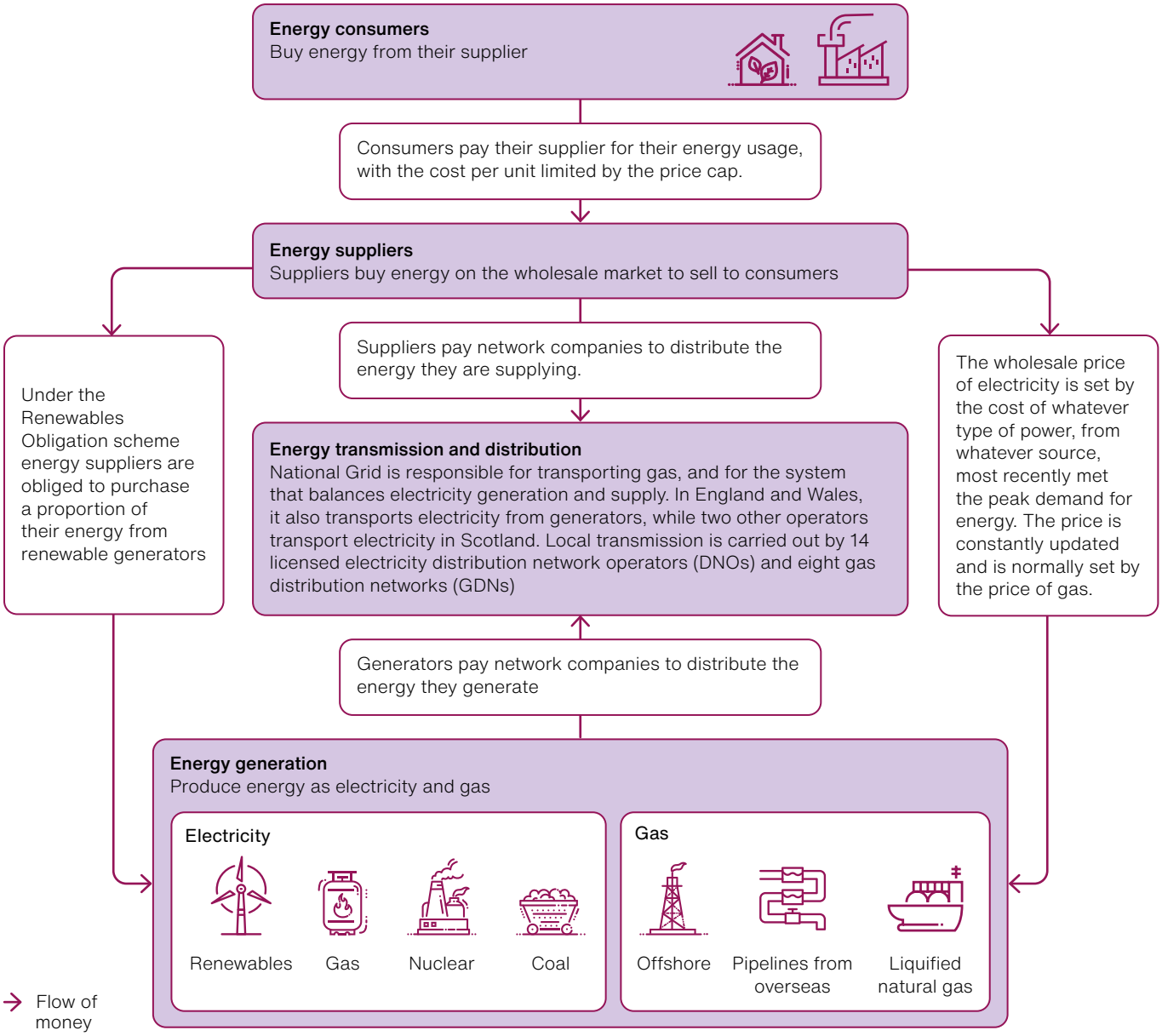
- describes the nature of the energy market in Great Britain;
- outlines the regulatory system for the energy supplier market;
- set out how the energy supplier market has developed in recent decades;
- explains how the price of energy is determined; and
- sets out information on future reforms to the supplier market.

The nature of the energy market

1.2 Most households and commercial premises in Great Britain are supplied with gas and electricity through the energy system. Gas provides the main source for heating homes and businesses and is also a major energy source for industry and electricity generation. There are four main components of the energy system: generation; transmission; distribution and retail (**Figure 1**).

Figure 1
The energy system in Great Britain

Energy suppliers buy energy on the wholesale market to sell to consumers



Notes

1 Energy companies are not always involved solely in one aspect of the market. Some energy companies that own and operate energy suppliers also own and operate other elements of the energy system, such as energy generation. In a scenario where wholesale prices rise, such vertically-integrated firms may lose money in one part of their operation, such as supply, but could be insulated overall if they are able to make profits in other areas, such as generation.

2 The Renewables Obligation came into effect in 2002 in England and Wales, and Scotland, followed by Northern Ireland in 2005. Renewables Obligation Certificates (ROCs) are certificates issued to operators of accredited renewable generating stations for the eligible renewable electricity they generate. Operators can trade ROCS with other parties. ROCs are ultimately used by suppliers to demonstrate that they have met their obligations.

3 This figure provides a simplified representation of relevant parts of the energy market. In practice, the energy market is more complex and involves additional actors and forms of trading not shown here.

Source: National Audit Office analysis

Oversight and regulation of the energy market

1.3 The Department for Business, Energy & Industrial Strategy (the Department) is responsible for setting and developing energy policy in Great Britain.[1] The Department was formed in July 2016 from the merger of the Department of Energy & Climate Change (DECC) and parts of the Department for Business, Innovation & Skills. Prior to this, DECC was responsible for energy policy.

1.4 The Office of Gas and Electricity Markets (Ofgem) is the regulator of gas and electricity markets in Great Britain.[2] Ofgem's principal objective is to protect the interests of existing and future consumers. In doing so it must have regard to other factors, including the need to ensure that licence holders can finance their regulated activities. Further information about the respective responsibilities of the Department and Ofgem with respect of the energy supplier market is set out in **Figure 2**.

How customers pay for energy

1.5 The largest element of customers' energy bills is the wholesale cost. Energy suppliers buy energy on the wholesale market to sell on to customers on the retail market. Because gas is used for electricity generation, both gas and electricity prices are affected by changes in the wholesale price of gas. There are several other elements, such as network costs and the cost of government policies aimed to meet environmental and social objectives. The percentage of customers' bills accounted for by these individual categories varies over time.

1.6 Customers are either on non-default tariffs, where they have made an active choice about their energy tariff, usually fixing it at a certain rate, or on default tariffs, where they are more likely not to have done so. Customers will automatically move to a default tariff at the end of their fixed deal unless they agree a new deal with their energy supplier. Since 2019, the government has capped the price per unit of gas and electricity for customers on standard default tariffs. The Department determined that bills should be capped following findings from the Competition and Markets Authority that 70% of customers of the six largest energy firms were on expensive default tariffs and customers were paying £1.4 billion more per year than they would in a fully competitive market.

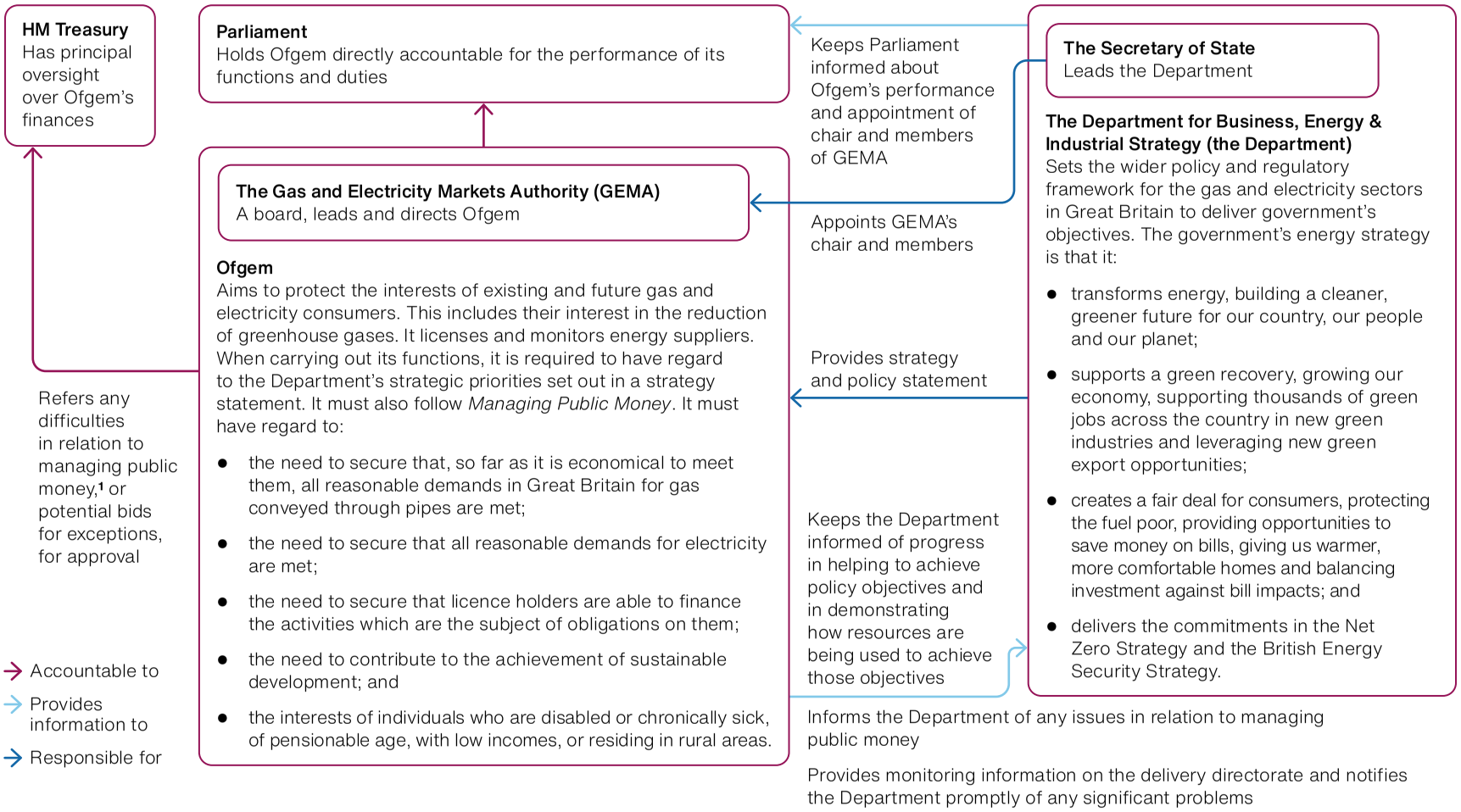
1.7 The price cap limits the rates suppliers can charge for the standing charge and for each unit of electricity and gas used. It does not cap individuals' total bills, which depend on how much energy they use. Ofgem sets the price cap by calculating how much it costs an efficient supplier to provide gas and/or electricity to a customer. Ofgem reviews the level of the cap at least once every six months to reflect changes in underlying costs, such as the wholesale cost of gas.

1 Energy policy in Northern Ireland is largely devolved to the Northern Ireland Executive.
2 In Northern Ireland the electricity, gas, water and sewerage industries are regulated by the Northern Ireland Authority for Utility Regulation. The regulation of the energy market in Northern Ireland is not included within the scope of this report.

Figure 2

The roles of the Department for Business, Energy & Industrial Strategy (the Department) and Ofgem in respect of the energy supplier market

Ofgem independently regulates energy suppliers but has regard to the Department's energy policy and strategy framework



Notes

1 HM Treasury sets out the main principles for dealing with resources in Ofgem and all other UK public sector organisations in *Managing Public Money*. See HM Treasury, *Managing Public Money*, March 2022, available at: www.gov.uk/government/publications/managing-public-money

2 The Department has not yet published its Strategy and Policy Statement. It told us it is currently working on a draft and aims to publish a public consultation on the Statement later in 2022.

Source: National Audit Office analysis of Department for Business, Energy & Industrial Strategy and Ofgem data

The energy supplier market

Key developments in the energy supplier market

1.8 The energy retail market operates separately from the generation, distribution and transmission elements of the energy system, although some companies operate across multiple elements. Prior to the opening of the market to competition, British Gas and the 14 regional public electricity suppliers had a monopoly to supply all domestic gas and electricity consumers in Great Britain. Freedom for domestic energy consumers to choose their supplier was introduced progressively between 1996 and 1999 (**Figure 3** on pages 19 and 20).

1.9 Energy suppliers potentially have an important role to play in achieving net zero. As the electricity generation mix transitions to being increasingly from intermittent renewable sources, such as wind and solar, electricity supply will be less predictable. This increases the value of flexible demand for electricity, which suppliers could have a key role in facilitating by introducing innovative customer offers such as time-of-use tariffs that charge less for electricity at times of day when overall demand on the system is lower.

Growth in energy supplier numbers

1.10 In the decade after it was opened to competition, the energy supplier market consisted of six large energy companies and a similar number of smaller suppliers. Since 2010, smaller companies entered the domestic energy supplier market in greater numbers. Between 2010 and May 2022, there were at least 73 new entrants into the domestic market and at least 65 exits (**Figure 4** on page 21). The number of suppliers increased from 12 in December 2010 to 23 in May 2022, with a peak of 70 suppliers in mid-2018. By September 2021 the new entrants held around a 40% market share. Some of these suppliers offered products and services that support customers to reduce their energy consumption or make their energy use more flexible, although some other new entrants primarily focused on price competition.

Energy supplier failures, 2021-22

1.11 During 2021 energy suppliers began exiting the market at a much faster rate than had ever occurred previously. Between July 2021 and May 2022, 29 suppliers (domestic and non-domestic) have failed.

Figure 3

Key events in the development of the UK energy supplier market since 1986

The energy supplier market has been through many changes since starting to open up to competition

1986	Jul		British Gas privatised through Gas Act
			Office of Gas Supply (Ofgas) established
1989	Jul		UK electricity sector privatisation provided for through Electricity Act
			Office of Electricity Regulation (Offer) established
1996	Dec		EU Electricity Directive increases scope for customers in EU member states to choose their electricity supplier
1998	Jun		EU Gas Directive increases scope for customers in EU member states to choose their gas supplier
2000	Jul		Utilities Act 2000 updated rules of electricity and gas markets
	Nov		Ofgas and Offer merged into Ofgem
2001	Mar		Ofgem sets out supplier of last resort (SOLR) process
2002	Apr		Renewables Obligation starts
2011	Jul		Electricity Market Reform announced
2013	Jun		Ofgem proposes six largest energy firms have to publish prices paid for wholesale energy and trade at those prices for two years
2014	Jun		Ofgem refers energy market to the Competition and Markets Authority (CMA)
2016	Jun		CMA publishes report concluding that 70% of the big six suppliers' customers were on expensive default tariffs and proposes a temporary cap on the amount suppliers can charge prepayment customers
	Jul		Department for Business, Energy & Industrial Strategy (the Department) formed
2017	Mar		Renewables Obligation closes to new generating capacity
	Apr		Ofgem introduces a price cap for customers on prepayment meters
	Oct		Government announces it would introduce an energy price cap on default tariffs
2018	Jul		The Domestic Gas and Electricity (Tariff Cap) Act 2018 receives Royal Assent
2019	Jan		Ofgem introduces price cap on default tariffs
	Apr		Ofgem publishes proposals on requirements for new energy suppliers
2020	Aug		Ofgem publishes outcome of review on whether conditions are in place for effective competition in domestic supply contracts

Figure 3 *continued*

Key events in the development of the UK energy supplier market since 1986

2021	Jan		Ofgem introduces financial responsibility principle for energy suppliers	
	Jul		The Department publishes its Energy Retail Market Strategy which includes an announcement that, subject to Parliamentary time and approval, it intends to legislate to allow for future extensions of the default tariff cap beyond 2023 if needed	
	Aug		Ofgem publishes its second review into whether conditions are in place for effective competition in domestic supply contracts. The review concludes that the price cap be extended to the end of 2022	
	Oct		Ofgem writes open letter to suppliers setting out actions to respond to wholesale price shock	
	Nov		The court makes Energy Supply Company Administration Order placing Bulb Energy into special administration. Three insolvency practitioners from Teneo are appointed special administrators	
	Nov		The Department enters into a funding agreement with Bulb Energy (in special administration) and its special administrators	
	Dec		Ofgem publishes action plan to strengthen financial resilience of energy suppliers and ensure risks are not passed on inappropriately to consumers	
2022	Feb		Government announce Energy Bills Rebate	
	Feb		Ofgem issues consultation on price cap methodology	
	Apr		Ofgem publishes proposals on customer credit balances and Renewables Obligations	
	Apr		Ofgem introduces market stabilisation charge	
	May		Government announces households will get £400 of support with their energy bills through an expansion of the Energy Bills Support scheme	

- Selected UK energy market events
- Selected UK energy price cap dates

Notes

1 Timeline is not to scale.

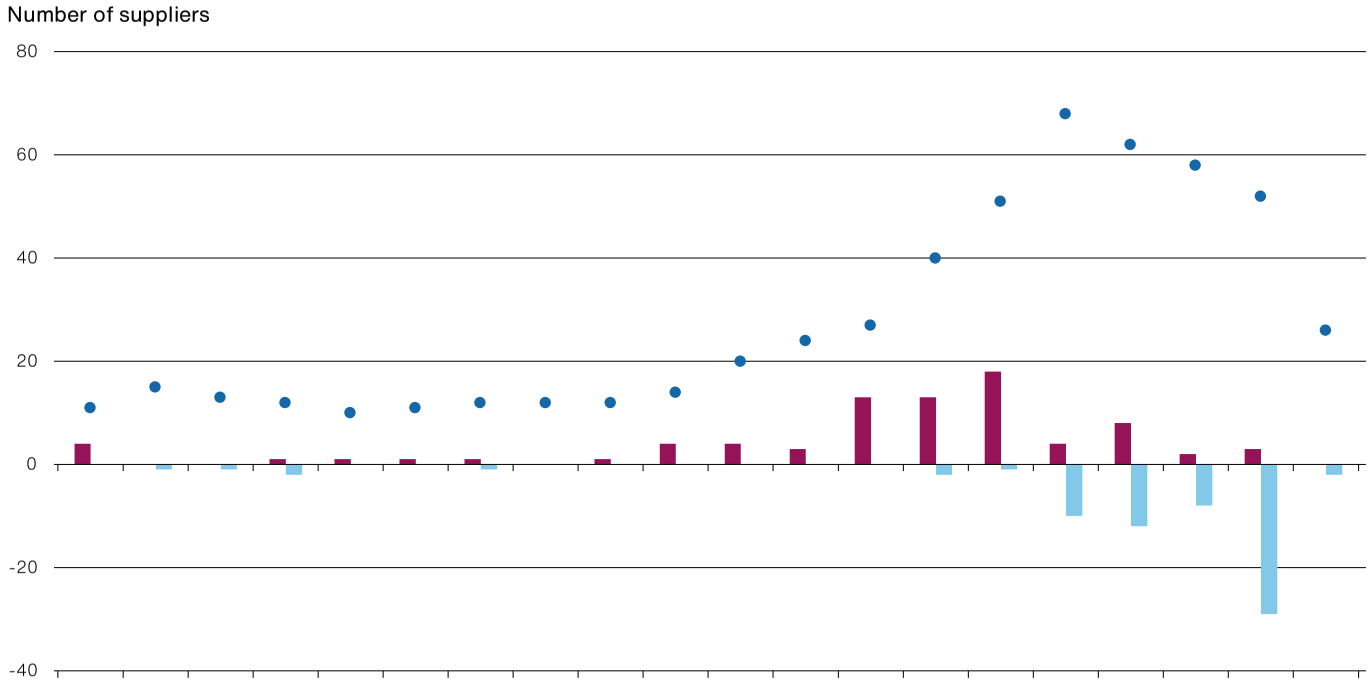
2 The price cap is updated twice a year and tracks wholesale energy and other costs. The level of the price cap is based on a household with typical consumption on a dual electricity and gas bill paying by direct debit. The price cap limits the rates suppliers can charge for the standing charge and for each unit of electricity and gas used. It does not cap individuals' total bills, which depend on the amount of energy they use.

Source: National Audit Office analysis of published data

Figure 4

Supplier entries and exits in the domestic energy retail market (Great Britain), January 2003 to May 2022

The number of suppliers in the market grew significantly from 2012, peaking in 2018



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022 to date
Entries	4	0	0	1	1	1	1	0	1	4	4	3	13	13	18	4	8	2	3	0
Exits	0	-1	-1	-2	0	0	-1	0	0	0	0	0	0	-2	-1	-10	-12	-8	-29	-3
Total domestic suppliers at start of year	11	15	13	12	10	11	12	12	12	14	20	24	27	40	51	68	62	58	52	26

Notes

1 Includes suppliers of gas only, of electricity only and of both fuels.

2 Prior to 2014, net entries and exits do not always match the reported change in total suppliers for the same period. This is because data for 2003 to 2014, 2016 to 2021 and 2022 were prepared on different bases and may not be directly comparable.

3 In addition to supplier failures, the data include corporate transactions such as mergers, and the entries and exits of existing business energy suppliers to and from the domestic energy market.

4 As these totals are for domestic suppliers only, they exclude three solely non-domestic energy suppliers that collapsed in 2021 and 2022 and whose customers were transferred via a 'supplier of last resort' process. They also exclude Bulb Energy, which has been moved into a special administration regime rather than exiting the market.

Source: National Audit Office analysis of Ofgem data

1.12 Ofgem has powers to protect households and businesses when suppliers leave the market in an urgent or unplanned way to maintain continuity of supply to customers. These include appointing a 'supplier of last resort' (SOLR) or applying, with the consent of the Secretary of State, for an 'Energy Supply Company Administration Order' to put in place a special administration regime (SAR). Ofgem guidance sets out that it will only seek the Secretary of State's consent for a SAR where the use of SOLR powers would not be feasible, such as doubts about the possibility of a viable SOLR or likely practical problems with their appointment. Under SAR, a special administrator runs the company until it is either: rescued (for example, through a restructuring); sold; or has its customers transferred to other suppliers. The process aims to reduce the risk of financial failure spreading across the energy market, for example where costs of supplying energy and honouring credit balances would affect the ability of a SOLR to serve their existing customers.

1.13 Since July 2021, Ofgem has transferred nearly 2.4 million customers of 28 failed energy suppliers to alternative providers through its SOLR process (**Figure 5**).[3] For one failed supplier, Bulb Energy, which had approximately 1.6 million customers, Ofgem and the Department chose to apply to court for a SAR.

Scope of the report

1.14 In response to the issues set out in Part One, the remainder of this report sets out to evaluate Ofgem's and the Department's roles in the events leading to the supplier exits and how well they handled them. It covers:

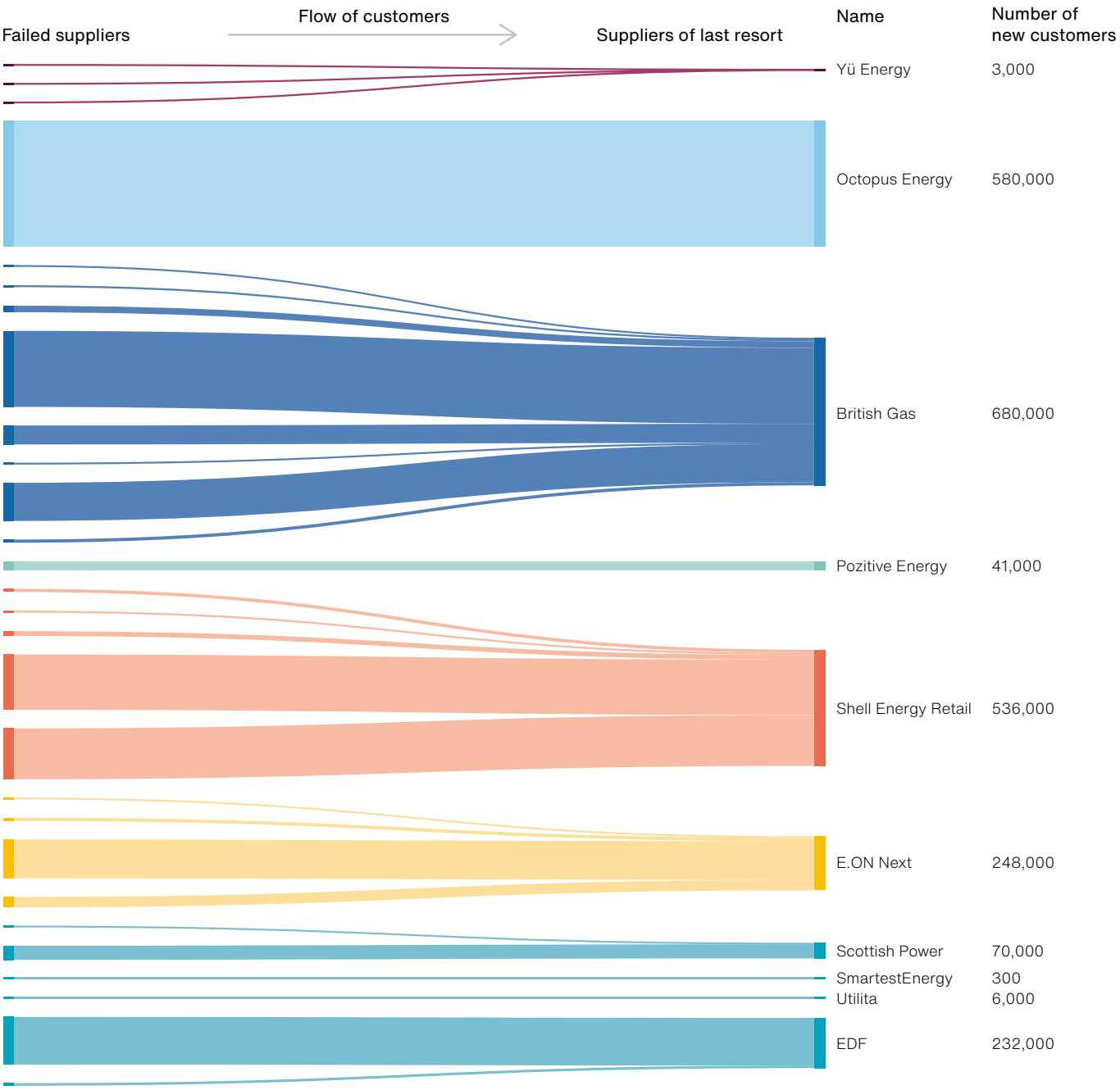
- Ofgem's and the Department's handling of supplier exits and their cost (Part Two); and
- Ofgem's regulation of the energy supplier market and how this contributed to the exits (Part Three).

3 Of these 15 supplied solely domestic customers; three supplied solely non-domestic customers; and 10 either supplied a mixture of both or the split was not specified. This represented 2.0 million domestic customers; 59,000 non-domestic customers; and 318,000 customers where the type of customer was not specified.

Figure 5

Flow of customers from failed suppliers to suppliers of last resort between July 2021 and May 2022

Ten suppliers of last resort took on customers from failed suppliers



Notes

1 Customer numbers are approximate and are rounded to the nearest 1,000 except in the case of SmartestEnergy.

2 Includes all customers (domestic, non-domestic and unknown).

Source: National Audit Office analysis of Ofgem, *What happens if your energy supplier goes bust*, May 2022, available at: www.ofgem.gov.uk/information-consumers/energy-advice-households/what-happens-if-your-energy-supplier-goes-bust?

Part Two

How supplier exits have been handled and what they have cost

2.1 This part covers:

- how effectively the Office of Gas and Electricity Markets (Ofgem) handled the transfer of customers to new suppliers through the supplier of last resort (SOLR) process;
- the cost of transferring customers to alternative suppliers through the SOLR process; and
- the process of taking Bulb Energy into special administration.

The SOLR process

2.2 The high number of supplier failures in 2021 led Ofgem to adapt its SOLR process and resourcing. It streamlined the process so that potential SOLRs could plan for what was coming. In early autumn 2021, Ofgem brought in people from other teams to shadow an ongoing SOLR and expanded the SOLR team. Suppliers recognised the level of effort that Ofgem had put into managing the SOLR process but also told us that Ofgem had not learned lessons from its previous experience of putting customers through SOLR in 2018. They noted that the process for applying to be a SOLR was unnecessarily burdensome and put both suppliers and Ofgem under pressure.

2.3 Since July 2021, Ofgem has transferred nearly 2.4 million customers without any interruption to their energy supply. However, a very small number of households on prepayment meters (fewer than 100) contacted Citizens Advice because they were disconnected in the period between their supplier failing and the SOLR being appointed. Issues resolving these cases included that: the failed supplier had not ensured their metering company could be contacted by the new supplier; the failed supplier had not made details of live or priority cases available to the incoming supplier; and the customer had an issue with their meter but could not get hold of either the failed or the new supplier to request assistance.

2.4 Citizens Advice and Ombudsman Services have statutory responsibilities to represent the interests of energy consumers across Great Britain. In December 2021 Citizens Advice published a report setting out its view on the issues leading to the exits of energy companies and the impact on consumers.[4] The report identified inconveniences and potential hardships experienced by many customers who transferred between suppliers. This included an immediate increase in their energy costs as they transferred from fixed rate to the standard variable tariff, which cost the average customer an estimated £30 per month more for the remainder of the duration of their original contract. Citizens Advice and the Ombudsman Services told us that among the main issues that customers of failed suppliers had complained to them about were: uncertainty regarding transfer of protected credit balances from one provider to another;[5] loss of debt repayment plans that help customers struggling to pay debt arrears, which particularly affected vulnerable households; delays setting up accounts and payments to new suppliers; and the inability to resolve issues relating to the supplier which had gone into administration, for example in relation to fixing faulty meters.

2.5 Ofgem held regular conversations with the suppliers who had taken on customers from those that had failed, to assess whether suppliers were responding to issues appropriately. Ofgem took action in some cases but was unable to take direct action for some complaints because, once a supplier has failed, it is no longer licensed by Ofgem (**Figure 6** overleaf). In November 2021 the Insolvency Service wrote to the professional bodies for insolvency practitioners to encourage practitioners to actively consider continuing previous arrangements that the failed energy suppliers may have had with vulnerable customers. It also highlighted the importance of providing SOLRs with data to enable customers to be transferred as smoothly and quickly as possible.

4 Citizens Advice, *Market Meltdown: How regulatory failures landed us with a multi-billion pound bill,* December 2021, available at: www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Market%20Meltdown%20-%20Dec%20 2021_v2%20(1).pdf

5 When a supplier fails its customers' credit balances are protected, but these can take some time to transfer between suppliers or be returned to customers.

Figure 6

Common categories of customer complaints regarding the supplier of last resort (SOLR) process and how Ofgem has responded to them

Ofgem has been unable to take direct action in relation to some categories of complaints

Type of complaint	Explanation of issue	The extent to which Ofgem has been able to address the issue
Increase in tariff when moving from a failed supplier to a SOLR	When customers are moved from a failed supplier to a SOLR they are likely to experience an increase in their energy bills if moving from a non-default to a default tariff. Citizens Advice has estimated the average price rise to be £30 per customer per month for the remainder of the duration of their original contract.	This is within the rules of the SOLR process and Ofgem would not seek to take any action in relation to this specific increase. However, in May 2022 the Secretary of State for Business, Energy and Industrial Strategy announced that Ofgem would take compliance action against suppliers who increased direct debits beyond what was required.
Delays in issuing final bills to customers, including transfer of credit balances between the failed supplier and the SOLR	The credit balances which customers hold when their suppliers fail are protected and customers are entitled to receive this money back. However, customers have experienced delays in receiving their final bills, and in the transfer of credit refunds from their new supplier. Suppliers have said that this is primarily because of delays in receiving data from the failed supplier or administrator.	Ofgem engages with the SOLR after they have taken on new customers as part of its compliance work. It would only consider taking enforcement action against a supplier if it felt that the supplier was not seeking to address the issues raised. Ofgem is consulting on options for introducing a principle which would ring-fence consumer credit balances in the case of future exits.
Cancellation of debt repayment plans	Some customers who have been on debt repayment plans, which help people who are struggling to pay debt arrears, have had these cancelled when moved to a SOLR. This can particularly impact on vulnerable families.	There is no obligation for the SOLR to honour a repayment plan but the SOLR does have to take account of the customer's ability to pay. As part of the SOLR appointment process Ofgem engages with the SOLR to understand how they will do this and encourages SOLRs to have a direct route for customers to contact them in relation to repayment plans.

Source: National Audit Office

The cost of transferring customers through the SOLR process

The SOLR levy process

2.6 Suppliers can recover the costs they incur as a SOLR. These costs are then passed onto domestic energy customers. A SOLR can make a claim for reasonable costs incurred, including those which are: additional to the costs of serving existing customers; incurred directly as part of the SOLR role; and otherwise unrecoverable, such as through the administration process or customer charges. After Ofgem approves the claims gas and electricity network companies pay the SOLR and recover the costs through their charges. These costs are then added to the standing charge of domestic electricity customers' bills as network costs and added to the unit costs of domestic gas bills. The standing charge is the portion of their bill incurred regardless of the amount of gas or electricity used. The unit rate is the portion of the bill which depends on energy usage.[6] Some stakeholders have criticised Ofgem's decision to add the levy to the electricity standing charge when customers cannot influence this cost by reducing their energy usage and, in May 2022, Ofgem committed to reviewing this.[7]

2.7 Usually, the earliest SOLRs would begin receiving payments for SOLR costs is from around 15 months from their appointment, with full repayment some 12–15 months later. However, Ofgem recognised that in the extreme market conditions at the time this timescale for handling SOLR levy claims would be too long and in December 2021 brought in measures to shorten the time between a SOLR being appointed and its costs being recovered. The change allowed SOLRs that had been appointed since 1 September 2021 to submit initial claims for the additional costs they had incurred to Ofgem to review and potentially start receiving payments from May 2022. Suppliers can then make a second claim during the summer and autumn of 2022 to receive payments from April 2023. The suppliers we spoke to were generally positive about the changes that Ofgem had made to the levy process to enable them to recover their costs more quickly.

6 Currently 55% of costs are recovered through domestic electricity bills, and 45% through domestic gas bills.
7 Business, Energy and Industrial Strategy Committee, *Oral evidence: Energy pricing and the future of the energy market*, HC 236, May 2022. Available at: https://committees.parliament.uk/oralevidence/10331/pdf/

The cost of supplier failures

2.8 Ofgem has approved claims worth £1.8 billion (around £66 for a typical customer paying for energy at the price cap) for the SOLR of 2.2 million customers from 22 suppliers which failed between September and December 2021, mostly to cover the cost of buying wholesale energy up to the end of March 2022 at prices above the price cap for these customers (see paragraph 2.9).[8] It expects a further £548 million of related claims under current rules both for those 22 suppliers for which it has already approved first claims, and for suppliers who failed after 1 December 2021 or had not previously submitted claims.[9] Some failed suppliers had also missed payments into the government's schemes to support renewable generation, which means a further £296 million of costs will be passed through solvent suppliers to consumers' bills, taking Ofgem's current estimate of the total cost of the supplier failure dealt with through SOLR to £2.7 billion (see **Figure 7**).[10] This would equate to around £94 per customer.[11] There are significant uncertainties which mean the total cost could go up, or down (paragraphs 2.10 to 2.12).

2.9 The size of the SOLR costs is affected by the price cap. SOLRs cannot charge their new customers more than the price cap, so they reclaim the part of the wholesale costs not covered by customers' payments through the SOLR process. If the price cap was not in place, SOLRs could charge their new customers more, and claim back less through the levy, in turn reducing the cost of supplier failure to consumers. In November 2021, after the first wave of winter 2021-22 failures, Ofgem undertook analysis which found that lifting the price cap high enough to stabilise other suppliers at risk would cost consumers more than mutualising their failure.

2.10 When assessing initial claims in December Ofgem limited the duration that SOLRs could claim based on when the SOLR was appointed and when the price cap would adjust but committed to consulting on the appropriate duration for the totality of the claims in early 2022. Ofgem is consulting on its approach to reimbursing the additional costs that suppliers who acted as SOLRs faced, to ensure it is fair. In particular, it is considering whether SOLRs should be allowed to recover costs incurred more than six months after their appointment, and if so, then for how long. Ofgem expects to make a final decision on this issue by September 2022, ahead of receiving the second wave of claims in relation to these 22 failed suppliers. The decision will impact the extent to which the costs being passed on to consumers through the levy will increase and could potentially be significant.

8 A very small proportion of customers, who had already entered into long-term fixed term deals before October 2021, will not have the levy added to their bills and this cost is absorbed by suppliers.

9 Since July 2021 there have been 28 failed suppliers which have gone through the SOLR process. Of these 28, four failed outside the first SOLR claim timeframe of 1 September to 1 December 2021. One failed in August 2021; one in January 2022 and two in February 2022. Of the 24 failed suppliers where SOLRs were eligible to claim there were two suppliers for which claims were not submitted by the 1 December deadline.

10 This is an early estimate. Ofgem will publish a revised calculation after its 2021-22 Renewables Obligation compliance round, which it expects to complete in October 2022.

11 This figure is an estimate based on the median household consumption for households on a default tariff paying for energy at the price cap.

Figure 7

Breakdown of Ofgem's best estimate of the total mutualised cost of winter 2021-22 supplier failures, under current rules, as at May 2022

Most of the estimated costs of supplier failure relate to buying wholesale energy at prices above the price cap

Cost category	Value of approved claims	Value of expected future claims	Total of approved and expected claims	Description
	(£m)	(£m)	(£m)	
Supplier of last resort levy	1,834	548	2,382	Reasonable costs incurred by suppliers taking on the customers of failed suppliers.
Of which:				
Wholesale	1,713	280	1,993	Shortfall between the wholesale cost of energy and the cost recoverable from customers on the price cap.
Credit balance	66	151	217	Cost of honouring customers' credit balances.
Working capital	48	79	127	Cost of finance.
Onboarding, migration and other	6	37	44	Additional operating costs.
Missed payments to support renewable energy generation	176	120	296	Missed payments into the government's schemes to support renewable energy generation.
Of which:				
Renewables obligation levy	172	118[2]	290	Cost to mutualise missed payments into the renewables obligation mechanism.
Feed-in tariff levy	4	2	6	Shortfall in payments into the feed-in tariffs scheme.
Total	**2,010**	**668**	**2,678**	Total expected mutualised cost associated with supplier failures, under current rules. The final figure is highly uncertain.

Notes

1 The value of expected future claims is highly uncertain. In February 2022, Ofgem expected between £400 million and £600 million of future claims, with £548 million as a best estimate.

2 This is an early estimate. Ofgem will publish a revised calculation after its 2021-22 Renewables Obligation compliance round, which it expects to complete in October 2022.

3 Figures may not sum due to rounding.

4 Mutualisation is the process by which the costs of the supplier of last resort process are spread across all domestic customers.

5 The approved Renewables Obligation figure of £172 million relates to the suppliers who failed to meet their 2020-21 obligations and failed after July 2021. The total mutualisation figure for Renewables Obligations for 2020-21 is £218 million.

Source: National Audit Office analysis of Ofgem data

2.11 Under insolvency law, the administrator has a general duty to act in creditors' interests as a whole. Ofgem is seeking a court ruling on whether it and SOLRs can make a claim as creditors in the administration of a failed supplier. The case relates to:

- Ofgem's ability to make a claim in the insolvencies of energy suppliers following their non-payment of Renewables Obligation Certificate (ROC) liabilities;[12] and
- the ability of SOLRs to make a claim against insolvent suppliers for the outstanding credit balances of customers who transferred to them and which the SOLR had to repay.

If Ofgem wins, this could reduce the total cost to consumers by up to around £0.5 billion based on the total value of approved and expected credit balance and Renewables Obligation claims but is likely to be significantly less than this.

2.12 On insolvency, administrators of failed suppliers will monetise assets of the company. This could include hedges, which are contracts to purchase wholesale energy at a fixed price in the future, which potentially hold market value at the point of collapse. There are a number of issues relating to the interaction between the insolvency regime and the hedges held by failed suppliers which mean that there may be opportunities to reduce the costs passed on to customers in the event of future supplier failures. For example, when a supplier fails, the value of any hedges remains as an asset of the failed company and is used to pay off creditors, and if sufficient funds are left, ultimately shareholders. The SOLR for the customers of the failed supplier can then re-hedge or buy energy at the spot price and claim back the cost through the SOLR levy. Ofgem is exploring changes to the licensing regime so that hedge values recovered from failed suppliers are used to offset SOLR costs. In its view this may partly help to reduce the cost to consumers of failure and incentivise better stewardship of suppliers as shareholders would be more at risk from failure. Ofgem also told us that, in its view, legislative change is also needed to fully protect consumers.

2.13 At least some element of the cost is likely to represent a transfer of costs between different time periods and different groups of consumers rather than an additional cost. For example, some of the cost transfer is likely to have been from more engaged customers who have previously benefited from lower energy costs to less engaged, or more vulnerable customers, who are more likely to have been on higher default tariffs. Consumers who were on low-cost tariffs with small suppliers, and consumers who were with larger suppliers that aimed to compete on prices with smaller suppliers, will have paid less in the years prior to 2021 than if the small suppliers had not entered the market.

12 Ofgem issues ROCs to electricity generators relating to the amount of eligible renewable electricity they generate. Generators sell their ROCs to suppliers. Suppliers who do not present enough ROCs to meet their obligation must pay a penalty to Ofgem.

Wider cost increases

2.14 The cost of supplier failures is a relatively small proportion of the overall bill increases that consumers have faced. The bill for a typical customer purchasing energy at the price cap paying by direct debit will have increased from £1,105 per year in the winter of 2018-19 to £1,971 in the summer of 2022, an increase of 78% (**Figure 8** overleaf). In May 2022 the chief executive of Ofgem told the Business, Energy and Industrial Strategy Committee that Ofgem's current estimate was that the price cap for a typical consumer would rise to around £2,800 from October 2022.[13] Of the increase between 2018-19 and summer 2022, 74% is driven by an increase in wholesale costs and 14% by an increase in network costs (driven by the increase in SOLR levy costs to around £66 per consumer). The average wholesale weekly price of gas rose nearly six-fold between February 2021 and December 2021, from £16 per megawatt hour (MWh) to £92 per MWh (**Figure 9** on page 33).[14] These average increases mask very significant volatility on individual occasions over the period. The actual price paid by individual consumers depends on several factors including: their level of energy usage; their choice of energy supplier; their tariff; and whether or not they are on a prepayment meter.

2.15 The additional £66 per customer resulting from the cost of the SOLR levy has already been reflected in the price cap calculation for 1 April to 30 September 2022 and is therefore being reflected in customers' bills at the same time as they are facing higher energy prices overall. Additional costs relating to the SOLR levy will be reflected in future periods. In March 2022 Ofgem announced that it intended to modify suppliers' licence conditions such that they could potentially use third-party finance to reduce the impact on customers.[15]

2.16 Suppliers told us that, in their view, there was no clear way in which they could currently exit the supplier market responsibly without using the SOLR process. Although new suppliers have been appointed through the SOLR process in each of the supplier failures to date, they also highlighted a risk that, in the future, suppliers would not be willing to take on the customers of failed suppliers. This is because of the additional risk of taking on more customers at a potential loss if prices remain volatile. Although in theory Ofgem can compel suppliers to become SOLRs for the customers of failed suppliers, suppliers thought that it was likely that future supplier exits might need to be managed through the special administration regime (SAR) process.

13 Business, Energy and Industrial Strategy Committee, *Oral evidence: Energy pricing and the future of the energy market*, HC 236, May 2022. Available at: https://committees.parliament.uk/oralevidence/10331/pdf/

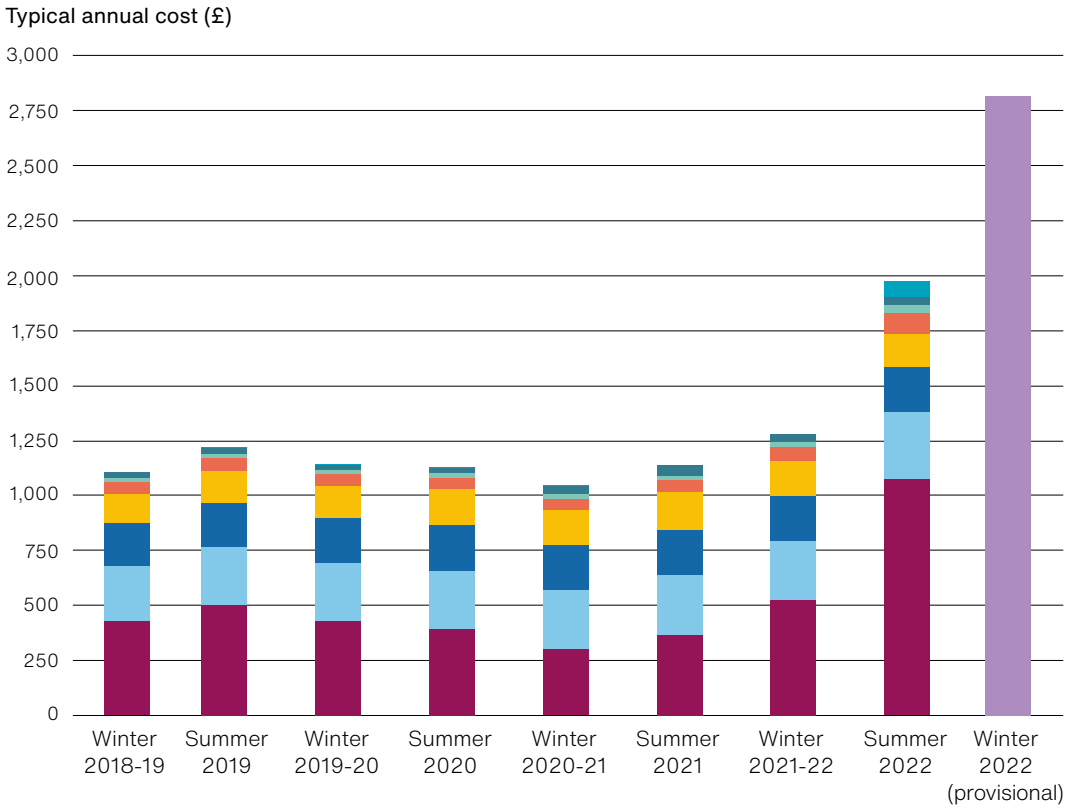
14 This is based on the price of gas bought through forward delivery contracts, calculated as a weekly average of a basket of specific quarterly and seasonal forward delivery contracts monitored by Ofgem.

15 Ofgem, *Decision on modifications regarding Last Resort Supply Payment Claims (LRSPs) for electricity supply, gas supply, electricity distribution and gas transportation licence conditions*, March 2022, available at: www.ofgem.gov.uk/sites/default/files/2022-03/Decision%20on%20modifications%20regarding%20Last%20Resort%20Supply%20Payment%20Claims%20.pdf

Figure 8

Breakdown of a typical bill for a customer on the price cap[1] between winter 2018-19 and winter 2022

The cost of supplier failures is only a small proportion of the overall bill increases that consumers have faced



	Winter 2018-19	Summer 2019	Winter 2019-20	Summer 2020	Winter 2020-21	Summer 2021	Winter 2021-22	Summer 2022	Winter 2022 (provisional)
Wholesale costs	434	505	432	395	307	373	528	1,077	
Network costs	250	260	262	265	265	268	268	305	
Operating costs	195	201	203	209	203	204	204	203	
Policy costs	130	144	146	160	162	172	159	153	
VAT	53	58	54	54	50	54	61	94	
Profit	20	22	20	20	19	20	23	35	
Other	23	25	24	24	37	47	35	38	
Supplier of last resort levy	0	2	2	0	0	0	0	66	
Total	**1,105**	**1,217**	**1,143**	**1,127**	**1,043**	**1,138**	**1,278**	**1,971**	**2,817**

Notes

1 These costs are for a domestic dual fuel bill paid by direct debit. Typical bills for customers using other payment methods are different.

2 The winter 2018-19 price cap applied for three months, from January to March 2019, instead of the usual six months.

3 Ofgem sets the price cap by calculating how much it costs an efficient supplier to provide gas and/or electricity to a customer. This figure presents the results of Ofgem's calculation.

4 Network costs exclude supplier of last resort levy costs.

5 Ofgem calculates the bill values using a 'typical domestic consumer' with 'medium' energy use. Since April 2020, typical consumption values for a medium consumer are 12,000 kWh/year for gas and 2,900kWh/year for electricity. Actual consumers' bills will vary according to their energy usage.

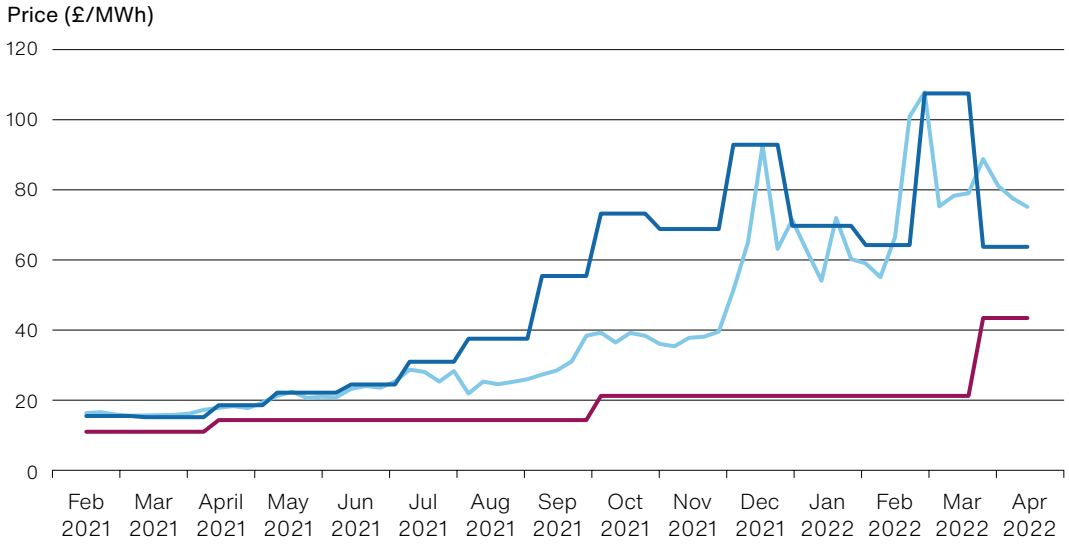
6 The measure of profit presented here is earnings before interest and tax.

Source: National Audit Office analysis of Ofgem data

Figure 9

Wholesale price of gas paid by suppliers, compared with gas price assumption in the default tariff charged to consumers, February 2021 to April 2022

There is a lag between suppliers paying higher (or lower) prices for energy, and their passing those costs (or savings) on to consumers on default tariffs[1]



Notes

1 This is because default tariffs are updated according to gas prices in an observation window starting nine months before the update.

2 'Forward delivery' contracts are agreements to deliver gas made weeks, months or years before the energy is needed by consumers. The forward delivery gas price dataset is calculated as a volume-weighted weekly average of specific quarterly and seasonal forward contracts. For more detail, see www.ofgem.gov.uk/energy-data-and-research/data-portal/wholesale-market-indicators, methodology notes.

3 Day ahead contracts are agreements made shortly before the energy is supplied. The figures presented here are monthly averages.

4 The price suppliers pay depends on their chosen hedging strategy. A supplier with more hedging is likely to pay prices closer to the 'forward delivery' average, while a supplier with less hedging is likely to pay prices closer to the 'day ahead' average.

5 Gas prices are for Great Britain.

Source: National Audit Office analysis of Ofgem data

Taking Bulb Energy into special administration

2.17 Bulb Energy is the largest supplier to have collapsed; it supplied approximately 1.6 million domestic customers prior to its collapse. The Department for Business, Energy & Industrial Strategy (the Department) and Ofgem had previously put in place plans for the collapse of a large energy supplier. This included obtaining approval from the Department's investment committee for the costs of running a business under SAR and lining up access to independent financial advisers in the immediate aftermath of an energy supply company insolvency. Ofgem told us it first became aware that Bulb Energy was in serious financial difficulty in late summer 2021. From September 2021, Ofgem was in discussion with Bulb Energy, the Department and HM Treasury regarding options for handling Bulb Energy's possible failure.

2.18 The Department recommended to ministers that if Bulb Energy were to fail then SAR would be the best option on the basis of its view that it was the most operationally straightforward to deliver. This was because it did not require a transfer of customers and it was the best option for ensuring that customers were protected and for maintaining a competitive market. In the Department's view it also avoided market concentration that would result from allocating a large customer base to one supplier, which would have been necessary because technical constraints meant it was not possible to spread Bulb Energy's customers across multiple suppliers. In October 2021 Ofgem compared the feasibility of handling Bulb's failure through either the SAR or SOLR processes, including an estimate of how much each option would cost. At that time Ofgem concluded that SAR would cost less than SOLR, with an estimated net cost of between £1.0 billion and £1.1 billion. This compared with Ofgem's estimated cost of £1.3 billion being passed on to consumers through the SOLR process. The costs of putting Bulb Energy into SAR can also be spread, rather than placing the significant expected SOLR levy claim on consumers' bills with most falling in a single year.

2.19 Bulb Energy suggested a third option – a 'backstop' SOLR – where Bulb Energy's customers would be transferred to a new company funded by private investment, with that company becoming the SOLR for Bulb Energy's customers. Bulb Energy claimed that this approach would be cheaper than either the SOLR or SAR. The Department and Ofgem did not pursue this option because, in their view, the cost savings relative to the other options would be dependent on voluntary decisions by the new investors, such as not seeking to recover customer credit balances, and because they believed it could be open to legal challenge from other suppliers.

2.20 On 24 November 2021 Bulb Energy was placed into SAR and administrators have continued to run the company since this date. Bulb Energy customers continued to be supplied with energy on their existing terms and therefore did not experience any interruption to their supply or immediate increase in the cost of energy.

The cost of Bulb Energy's special administration

2.21 During 2021-22 the Department spent £0.9 billion to enable an administrator to run Bulb Energy.[16] The main cost was purchasing energy on the wholesale market. The Department has worked with Bulb Energy's administrators to agree an approach that does not involve hedging on the grounds that hedging would be too close to speculation, which is discouraged by *Managing Public Money*.[17] This means that taxpayers are exposed to any rises in wholesale energy prices while Bulb Energy is in special administration, although conversely taxpayers benefit where the market price falls below what Bulb Energy could have hedged at. Gas prices have continued to be very volatile since the start of 2022: the day ahead gas price peaked in March 2022 at 175 £/MWh following Russia's invasion of Ukraine and fell to 9 £/MWh in May.

2.22 HM Treasury has budgeted £1.0 billion for the Department to run Bulb Energy during 2022-23. The costs to run Bulb Energy in 2022-23 may go up or down depending on the wholesale price of energy and the length of time Bulb Energy is in special administration. The final cost of taking Bulb Energy into special administration will not be known until it is sold or wound up, because the costs incurred could be offset by any sale proceeds it is able to obtain. The cost so far has fallen to taxpayers as part of general government spending, but the Department has the power to recover the final net cost through a levy on consumer bills, at a time of its choosing, which it plans to do.

16 At the time of publication of this report, the Department had not yet published its accounts for 2021-22 and the financial audit of these accounts was not yet complete. This number is therefore potentially subject to change.

17 For exotic transactions, *Managing Public Money* states that, sometimes public sector organisations face financial risks which they find uncomfortable. In these circumstances they may consider hedging using commercial financial instruments. Speculation is never acceptable.

Part Three

The regulation of the energy supplier market and how this contributed to the exits

3.1 This part assesses the reasons why 29 suppliers have failed since July 2021, including:

- the financial resilience of the energy supplier market by 2021;
- the extent to which the Office of Gas and Electricity Markets' (Ofgem's) approach to licensing and monitoring of energy suppliers contributed to the exits; and
- the impact of the introduction of the price cap.

Suppliers' financial resilience

3.2 Ofgem commissioned the consultancy company Oxera to undertake an independent review of the energy retail market, which it published in May 2022.[18] Oxera reviewed the financial positions of a sample of both suppliers that failed and those still operating. It found that most or all of the failed energy suppliers in its sample had characteristics which exposed them to volatility in the energy market including:

- **negative and deteriorating equity balances in the years leading up to their failure.** Equity balances are the net value of the supplier after paying all its debts and are a crucial measure of a company's ability to absorb short-term and long-term shocks. All the failed suppliers in Oxera's sample had negative equity balances;
- **poor liquidity and low levels of capital**. Liquidity is a measure of a company's assets that are cash or can easily be converted into cash, such as inventory, which can be used to meet short-term cash requirements. Companies with lower levels of liquidity (less access to cash) than their peers are generally less resilient to short-term shocks;

18 Oxera, *Review of Ofgem's regulation of the energy supply market*, May 2022, available at: www.ofgem.gov.uk/publications/review-ofgems-regulation-energy-supply-market

- **over-reliance on customer credit balances to finance operations**. Oxera found that most failed suppliers in its sample had relatively high levels of reliance on customer credit balances as a proportion of their assets, compared with suppliers that continue to operate; and
- **either unhedged or not substantively hedged positions**. Hedging is a commonly used strategy where energy suppliers agree contracts to fix the price of energy purchased from the wholesale market for a certain period to reduce their vulnerability to volatility in the market. Oxera found that failed suppliers had, on average, poorer hedging arrangements than suppliers that are still active. We reviewed the administrators' reporting on issues leading to each supplier's insolvency for 24 out of the 29 suppliers that have failed since July 2021 and found that 17 (71%) mention insufficient hedging.

3.3 Oxera identified that some fast-growing suppliers had pursued unsustainable business models, which were particularly exposed to supply or demand shocks. This includes:

- a 'timing' model, where suppliers enter the market when the prevailing wholesale price is low and undercut rival companies that hold hedges at a higher price. Without hedging, this strategy would eventually lead to failure if wholesale prices increase; and
- a 'growth' model, where businesses rely on receiving customer balances before providing services and using these prepayments to fund the ongoing costs of the business. This relies on continued growth of the customer base, meaning it is unsustainable if that growth slows.

While the evidence Oxera collected suggested these business models had been used by some suppliers, it is not possible to determine the extent to which they were used because of limits in the information Ofgem holds.

Ofgem's approach to licensing and monitoring energy suppliers

Ofgem's approach following the opening of the market to competition

3.4 Following the decision to open up the market, Ofgem took a 'low bar' approach to encourage more suppliers into the market that would compete on price and bring innovation. It mainly assessed its success in regulating the supplier market by measuring the number of new entrants, how many customers were switching to them and the savings they were making. It did not measure the financial resilience of the market. Ofgem considered that market exit is a normal occurrence in any competitive market and that suppliers can fail for any number of reasons. Before 2021, when suppliers had failed the process of reallocating customers to a new supplier had come at minimal cost to consumers. Accordingly, Ofgem's regulatory regime was not designed to prevent supplier failure, rather to minimise the impact and disruption of any failure for customers.

3.5 Ofgem's approach manifested itself in how it licensed new suppliers and its monitoring of suppliers in the market:

- **Licensing:** When new entrants began to enter the market in the early 2000s, Ofgem required licence applicants to submit a considerable amount of information, including business plans and financial statements. But as the market matured, Ofgem reduced its information requirements and no longer requested information about suppliers' business model, working capital, financial viability or compliance arrangements. Since 2002 Ofgem has not formally refused any licence applications.[19] Ofgem operated what it termed a 'low bar' approach to licensing energy suppliers to encourage new entrants into the energy market.
- **Monitoring:** Before 2016, Ofgem required suppliers to provide quarterly and annual data on some areas of their operations, such as customer debt levels and disconnection rates. After 2016, Ofgem responded to increased instability in the market by enhancing its monitoring for a period, prioritising suppliers potentially at risk of failure by examining the tariffs they were charging, how much they were growing and whether they were hedging appropriately. However, its monitoring was designed to identify a shortlist of suppliers at risk of needing the 'supplier of last resort' (SOLR) or 'special administrative regime' (SAR) processes to be enacted, rather than provide Ofgem with intelligence of the financial risks facing the supplier market as a whole. This monitoring also did not provide Ofgem with information about suppliers' business models, meaning it was unsighted on the risky strategies many small suppliers employed.

3.6 Ofgem's activities to attract new entrants to the energy market were supported by the Department for Business, Energy & Industrial Strategy (the Department), which exempted new suppliers from some industry levies and policy costs such as the Warm Home Discount paid by suppliers with a customer base of more than 150,000. Additionally, the Department's Renewables Obligation scheme enabled suppliers to operate in the market without committing large amounts of their own capital or charging tariffs that covered their costs. This is because suppliers collect consumer money to cover the cost of the Renewables Obligation throughout the year but only pay this over once a year, in August, enabling them to use the money as a form of temporary working capital.

19 Ofgem told us that, while it had not formally refused any licences, it had informed some licence applicants that it was "minded to" refuse their application, at which point the applicants normally withdrew.

Tightening of rules after 2018

3.7 Ofgem began to recognise the potential vulnerability of the supplier market in 2018. In November 2018, following a series of supplier failures and some inadequate service provision, Ofgem consulted on new entry requirements for energy suppliers. In April 2019 it published its final proposals to undertake a qualitative assessment of information provided by potential new entrants against three criteria: having appropriate resources to operate; their understanding of obligations; and being fit and proper to hold a licence. It subsequently introduced these new regulations in July 2019. Since July 2019 there have been seven new entrants to the domestic energy supply market. All seven new domestic suppliers entered the market on licences granted prior to the 2019 changes, meaning they have not been through the new assessment.

3.8 Also in 2018, Ofgem began considering different options for tightening rules for existing suppliers. However, it did not implement any changes until January 2021. Ofgem told us that introducing new requirements for existing suppliers was extremely complex and it was not realistic that it could address those quickly. Members of the Ofgem board told us that, while the board had been uncomfortable about the state of the market for some time and knew it had needed reform, it did not have the space or time to focus on this due to Ofgem's many other priorities. This included, during this period, the rapid implementation of the price cap (see paragraph 3.25), which absorbed a substantial amount of Ofgem's capability. Ofgem plans to assess the extent to which earlier implementation of its changes would have reduced the risk or cost of supplier failures since 2021.

3.9 The changes Ofgem implemented from January 2021 included:

- a new financial responsibility principle. This makes it a legal requirement for suppliers to manage responsibly any costs that could be mutualised and create new costs for taxpayers;
- new checkpoints for customer and financial numbers where Ofgem would scrutinise suppliers' readiness to meet their new obligations;
- a requirement that suppliers would undertake an independent audit at Ofgem's request; and
- a requirement that suppliers would have sufficient capability and effective risk management practices.

3.10 Despite the reforms introduced in January 2021, Ofgem's approach to licensing and monitoring suppliers combined with the SOLR process effectively meant that shareholders had nothing to lose from exiting the market. Oxera's review found some suppliers did not have enough "skin in the game" and that there were several regulatory options which Ofgem could have pursued which would have mitigated either the risk or cost of supplier failure, or both. This includes requiring a substantial commitment of shareholder equity prior to market entry; setting and monitoring minimum levels of capital adequacy; and requiring a higher degree of assurance over the sustainability of the business models that suppliers employed. The lack of such measures meant there was little incentive for suppliers to guard against risk.

Ofgem's actions since the supplier failures

3.11 Ofgem has introduced measures aimed at strengthening its financial regulation of suppliers. In December 2021, Ofgem published its action plan on financial resilience.[20] This set out that Ofgem would improve its collection and reporting of information on: suppliers' financial and operational preparedness to supply new and existing customers; their strategies for risk management; and their approach to hedging, customer credit balances and pricing. Ofgem plans to use this information to gain assurance that suppliers are following the financial responsibility principle and managing their costs and risks appropriately. It also set out plans to introduce stress tests to assess how robust suppliers would be to shocks such as price volatility, a cold winter or bad debt.

3.12 Ofgem has plans to improve the amount of information collected, the analytical tools it is using and its scenario-testing and has bid for new staff to help it analyse submissions, as part of its wider request for additional resourcing. Longer term, Ofgem states it wants to take a more sophisticated approach to collecting and managing data to allow it to oversee the market efficiently. Some suppliers we spoke to were concerned that some of the new information requirements that Ofgem is introducing are burdensome and that Ofgem has not made enough use of publicly available information, such as company accounts, to inform its monitoring of the market.

20 Ofgem, *Action plan on retail financial resilience*, December 2021, available at: www.ofgem.gov.uk/sites/default/files/2021-12/Action%20plan%20on%20retail%20financial%20resilience1639491689844_1.pdf?msclkid=33e195e6d13511eca3651bb924069473

3.13 Ofgem is introducing changes aimed at reforming the existing regulatory framework for suppliers:

- In April 2022 Ofgem published proposals on customer credit balances and Renewables Obligations aimed at reducing the potential for suppliers to operate with unsustainable business models and to reduce the cost to consumers should they fail.[21] On credit balances it proposed that suppliers should ring-fence an amount equal to gross credit balances net of unbilled consumption. It also stated that it is considering ring-fencing Renewables Obligation payments and it is conducting a consultation on ring-fencing of credit balances and Renewables Obligations.

- Also in April 2022, Ofgem introduced a new market stabilisation charge. This requires suppliers acquiring a new customer to pay a charge to the customer's previous supplier if prevailing wholesale prices are below a certain amount. Ofgem intends that this will help suppliers to manage energy price volatility and reduce the risk for consumers of further costly supplier failures. In May 2022, Ofgem revised this charge to reduce the threshold for when it would be triggered and increase the amount the new supplier would need to pay the old supplier.[22]

3.14 Longer term, Ofgem intends to roll out and test a new regulatory framework that aligns with the future consumer landscape. In future, Ofgem expects consumers to have more choice over the products and services they can buy in the energy market and to make more decisions on how to manage their energy needs, with better data and new tools helping consumers to navigate these decisions. Ofgem expects this transformation to begin from 2025 onwards.

21 Ofgem, *Update to December Action Plan: Customer Credit Balances and Renewables Obligation protection*, April 2022, available at: www.ofgem.gov.uk/sites/default/files/2022-04/CCB%20%26%20RO%20Open%20Letter%20April%202022%20.pdf?msclkid=c2e5e0e8d13511ec80f51e1b74639fdb

22 The changes meant the threshold (the percentage wholesale price fall below the price cap assumptions) was reduced from 30% to 10% and the derating factor (the percentage of incremental hedging losses covered by the charge) was increased from 75% to 85%.

3.15 Ofgem's proposals have drawn a mixed reaction from stakeholders. Some have welcomed elements of the proposed changes. For example, Citizens Advice said that the steps that Ofgem has taken should ensure new and growing companies are able to meet their obligations, but also noted slow progress on other elements of the reforms.[23] Others have said they are concerned that the changes will inadvertently increase consumers' bills at a time of wider cost-of-living pressures because they create barriers to competition in the market, or because they will increase suppliers' operating costs. Some stakeholders have told us they are concerned that Ofgem's programme of reforms might prevent new entrants to the market that could provide the innovation required to support the achievement of net zero. Suppliers we spoke to had mixed views on the reforms. Some recognised the need to increase monitoring or regulation around financial resilience, but some also noted that this came at a potential cost to consumers. Some were also concerned that Ofgem was making unnecessary requests for data.

3.16 Ofgem recognises that there are trade-offs to be made in its reforms and that it will need to strike the right balance between increasing resilience, enabling innovation and not increasing long-term costs for consumers. It plans to publish analysis on the long-term costs and benefits to consumers that compares the potential impact on bills of having tighter rules for suppliers with the benefits for consumers from fewer suppliers failing. However, the relative benefits for different groups of consumers will vary depending on factors such as their propensity to switch suppliers to obtain the best deal.

3.17 Ofgem is introducing its programme of changes before the expected role of suppliers in achieving net zero has been clarified. In July 2021, prior to the multiple supplier failures, the Department published its *Energy Retail Market Strategy for the 2020s*.[24] The strategy set out the Department's vision for a market which enables net zero, ensures consumers pay a fair price for their energy, and encourages energy companies to invest in innovative products and services to unlock the benefits of low-carbon technologies. In December 2021, the Department announced that, while it believed its vision to be the right one, it needed to refresh the strategy to ensure it took account of lessons from recent months and ensure the energy retail market is resilient, sustainable, and continues to protect customers as the UK moves to a net zero energy system. It launched a call for evidence to feed into the refreshed strategy and stated that it aimed to publish a new strategy as soon as possible once the market had stabilised.[25]

23 Citizens Advice, *In 2021 the retail energy market was broken – how much progress has been made to fix it?*, March 2022, available at: https://wearecitizensadvice.org.uk/in-2021-the-retail-energy-market-was-broken-how-much-progress-has-been-made-to-fix-it-7b0181a3349e

24 Department for Business, Energy & Industrial Strategy, *Energy Retail Market Strategy for the 2020s*, July 2021, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1005307/energy-retail-strategy.pdf

25 Department for Business, Energy & Industrial Strategy, *Future of the energy retail market: call for evidence*, December 2021, available at: www.gov.uk/government/consultations/future-of-the-energy-retail-market-call-for-evidence?msclkid=d28755c2d13111ecae201b638a777ad0

Compliance and enforcement

3.18 It is important that Ofgem ensures it has the powers and capacity to enforce its new rules. When Ofgem becomes aware that a supplier might be breaching its regulations, either through direct referrals or other means, it begins compliance work to investigate. It will engage with the supplier to address the issue and will refer the case for formal enforcement action if it cannot be resolved.

3.19 Citizens Advice refers breaches of regulatory obligations to Ofgem. It told us that Ofgem had often been slow to act on potential breaches of licensing conditions. Citizens Advice also told us that Ofgem had not enforced new rules which it introduced in March 2021 requiring that all suppliers should establish customer supply continuity plans in the event of exits from the market and that only one out of the 20 suppliers who failed prior to mid-November 2021 had such a plan in place. Ofgem told us its work on ensuring compliance with the plans had been overtaken by the crisis relating to supplier exits and it had prioritised obtaining the information from suppliers necessary to run the SOLR process.

3.20 Ofgem is seeking additional powers and resources to enable it to act more quickly when stakeholders raise issues of non-compliance with them. For example, Ofgem and the Department are considering whether Ofgem needs more supervisory powers, such as being able to undertake direct checks on companies which it believes are not complying with its regulations. It has bid for additional staff in its retail compliance team to tackle non-compliance, as part of its wider request for additional resourcing. Some suppliers told us that they were concerned that Ofgem was asking for additional powers when it was not using its existing powers sufficiently. For example, they thought Ofgem could have taken earlier action against suppliers that did not pay their Renewables Obligations on time.

The price cap

Impact of the price cap on supplier failures

3.21 Some stakeholders have partly attributed the supplier failures to the price cap:

- In February 2022, giving evidence to the Business, Energy and Industrial Strategy Committee, Ofgem's chief executive officer said the price cap was one of three contributors to the supplier failures, along with the spike in gas prices and many suppliers' lack of financial resilience. In his evidence he noted that the price cap restricted suppliers' ability to respond to the increase in prices.
- Of the 24 administrators' reports on suppliers that failed since July 2021, 18 (75%) mentioned the price cap as a contributing factor.
- Oxera found that the price cap exacerbated suppliers' vulnerability to external shocks because the price cap's six-month update cycle meant a lag in suppliers' ability to pass wholesale cost increases on to customers.

3.22 It is likely that many suppliers would have failed even without the price cap existing given their lack of financial resilience. With the exception of Bulb Energy, all of those who exited the market were small or medium-sized suppliers, and as at April 2021 the majority of these had more than half their customer base on a fixed-price tariff. This could have limited these suppliers' capacity to put up their prices to recover the cost increase in the wholesale price of energy even without the price cap existing.

3.23 The price cap has had other impacts on the supplier market where wholesale prices have been higher than the price cap. As noted in paragraph 2.8, the vast majority of consumer costs resulting from supplier failures is to make up the difference between what SOLRs can charge consumers under the price cap and the cost of purchasing energy on the wholesale market. The price cap also means there is currently very little competition in the market on price: over the year between April 2021 and April 2022 the number of customers on the price cap (both default tariff and prepayment customers) increased from approximately 15 million to 22 million. As a high proportion of the population are currently paying the same rate for their energy, there is currently very little movement between tariffs and suppliers. For example, the number of electricity and gas switches in February 2022 was 83% below the number observed in February 2021.

The implementation of the price cap

3.24 Ofgem did not sufficiently consider all the potential implications of the cap if wholesale prices increased substantially or how it would interact with the SOLR process. When introducing the price cap, Ofgem undertook some modelling to understand its potential impact on supplier resilience, primarily in relation to the 'big six' energy suppliers. Although it understood that the price cap could make suppliers – especially small suppliers – more vulnerable to price shocks, it did not stress-test the price cap's design in depth. It considered that by including some financial headroom in the price cap, and updating the cap every six months, it had mitigated this risk.

3.25 There are several factors that led to this relative lack of scenario-planning:

- The legislation introducing the cap required Ofgem to implement it as soon as practicable, putting it under pressure to act quickly. Its main work to develop the cap started in October 2017; by the end of May 2018, it had defined its options and in November 2018, after a consultation, it announced the final design.
- Both the Department and Ofgem considered the price cap would be a temporary measure. The legislation under which the cap was introduced placed a requirement on Ofgem to review the need for the cap every year and for it be in place until 2023, at the latest.[26]
- Members of the Ofgem board told us that, in retrospect, it was clear that no one did sufficient joined-up thinking about the connections between the price cap, the low barriers to entry to the market and the lack of financial monitoring.

3.26 The lack of planning for possible scenarios is something we have seen repeatedly across government. Our reporting on the COVID-19 pandemic highlighted that although the government had plans for an influenza pandemic, it did not have detailed plans for many non-health consequences and some health consequences of a pandemic like COVID-19.[27] We found that since before the pandemic, stakeholders have identified areas for improvement in the government's approach to risk assessment in preparation for civil emergencies and malicious attacks. These include that government does not sufficiently explore high-uncertainty risks (where estimating the likelihood is difficult); risks that may materialise beyond a two-year timeframe; and the impact that multiple risk events would have if they took place at the same time.

26 *Domestic Gas and Electricity (Tariff Cap) Act 2018*, available at: www.legislation.gov.uk/ukpga/2018/21/contents/enacted

27 Comptroller and Auditor General, *The government's preparedness for the COVID-19 pandemic: lessons for government on risk management*, Session 2021-22, HC 735, National Audit Office, November 2021.

The future of the price cap

3.27 Ofgem designed the price cap to operate in a relatively stable market. It is considering how to update the cap in light of the increased market volatility, which could bring unintended consequences. In February 2022, Ofgem issued a policy consultation on changes to the price cap methodology. This set out changes it expected to make to the cap to ensure it reflects the underlying costs and risk to energy suppliers of supplying energy to default customers. This included seeking feedback on moving from six-monthly to quarterly updates of the price cap.[28] In May 2022 it issued a further consultation in which it confirmed its preference to move to quarterly updates of the price cap from October 2022.[29]

3.28 The government announced in the Queen's Speech in May 2022, that it intended to bring forward an Energy Bill which would include enabling the extension of the price cap beyond 2023. The government stated that the bill would protect consumers from unfair pricing and that "the price cap is the best safety net for millions, preventing suppliers from overcharging customers".[30]

3.29 Since the introduction of the price cap in 2019, neither the Department nor Ofgem has undertaken a full evaluation of its costs and benefits to consumers. Ofgem's latest assessment of the need for the price cap, in August 2021, found that since its introduction, on average across the five large suppliers,[31] operating costs had fallen and the companies had pursued efficiency programmes, decreased their operating costs and become loss-making. Ofgem told us that there may be benefits from alternative forms of price cap, but that it may require the Department to make legislative changes.

28 Ofgem, *Consultation on Medium Term Changes to the Price Cap Methodology*, February 2022, available at: www.ofgem.gov.uk/sites/default/files/2022-02/Medium%20term%20price%20cap%20changes%20policy%20consultation%20Feb%202022%20%281%29.pdf

29 Ofgem, *Price cap - Statutory consultation on changes to the wholesale methodology*, May 2022, available at: www.ofgem.gov.uk/publications/price-cap-statutory-consultation-changes-wholesale-methodology

30 Prime Minister's Office, *The Queen's Speech 2022*, May 2022, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1074113/Lobby_Pack_10_May_2022.pdf

31 The 'five large suppliers' are: British Gas, E.ON, EDF Energy, Scottish Power and SSE (now part of OVO). Npower, which was previously one of the big six, was acquired by E.ON in 2019.

Appendix One

Our audit approach

Scope

1 We examined the energy supplier market following extensive media and Parliamentary interest in supplier exits and the impact on consumers during late 2021. This report aims to set out the facts regarding the recent exit of energy suppliers and to evaluate the Office of Gas and Electricity Markets' (Ofgem's) and the Department for Business, Energy & Industrial Strategy's (the Department's) roles in the events leading to the exits and how well they handled them. It covers:

- the nature and regulation of the energy supplier market;
- how supplier exits have been handled and what they have cost; and
- the regulation of the energy supplier market and how this contributed to the exits.

2 This report does not draw conclusions on value for money and we do not evaluate wider issues relating to the supply and price of energy, such as policy considerations relating to the generation of energy, instalment of insulation, or whether and how to reduce the impact of the increase in energy prices on consumers.

Methods

3 In examining these areas, we drew on a variety of evidence sources, which we analysed between March and May 2022.

Interviews

4 We carried out 12, mostly online, interviews with the chief executive officer, officials and two non-executive directors from Ofgem, selected to participate because of their job roles and their relevance to the audit. This included staff responsible for (or involved in):

- retail energy market regulation;
- analysis and assurance;
- enforcement action;
- compliance activity;
- energy price cap setting;
- supplier of last resort (SOLR) and special administration regime (SAR) processes; and
- the lessons learned review conducted by Oxera.

5 We also held three online interviews with officials from the Department, responsible for (or involved in):

- Ofgem sponsorship;
- the energy price cap and market stability; and
- the special administration of Bulb Energy.

6 We used these interviews to understand the:

- handling of the 2021-22 supplier failures including whether plans for SOLR and SAR were followed, whether consumers have been protected and lessons learned from supplier failures;
- licensing of suppliers and how Ofgem applies controls to ensure financial resilience;
- rules on supplier resilience including: the timing and consideration of changes to the rules to new and existing suppliers; the extent to which any suppliers have failed since rules were changed in 2019 and 2021; the extent of enforcement action against suppliers not complying with the rules; and what information Ofgem has on suppliers' resilience;
- introduction of the price cap and the extent of Ofgem's and the Department's consideration of different scenarios and their consequences and any subsequent changes to Ofgem's monitoring of suppliers; and
- roles and relationship of Ofgem and the Department.

7 In addition, we held a face-to-face interview with an official from HM Treasury to understand its role in decisions relating to the energy supplier market and on the special administration of Bulb Energy.

8 We held online interviews with wider stakeholders in the energy sector, and other interested parties. Our questions were tailored to reflect each stakeholder's role and the areas of our audit that they would be best placed to speak to. We interviewed:

- Oxera;
- Citizens Advice;
- Energy UK;
- Ombudsman Services; and
- the Competition and Markets Authority.

9 We used these stakeholder interviews to understand the:

- work and findings of Oxera, the independent consultancy company, commissioned by Ofgem to conduct a lessons learned review of its role in the recent supplier failures as regulator of the retail energy market in Great Britain;
- consumer impact of supplier failures, including the cost and continuity of supply; and
- effectiveness of the price cap and the SOLR and SAR processes, and Ofgem's monitoring of supplier resilience.

Workshops

10 We carried out two online workshops with 10 representatives from nine energy suppliers. The workshops were set up with assistance from Energy UK, who issued invitations to its members.

11 We used these workshops to explore a range of issues and draw out key themes relating to the historical and current state of the energy supplier market, and impact of Ofgem's regulation of the market. In particular, we sought to understand views on:

- Ofgem and the Department's handling of supplier failures including the SOLR and SAR processes;
- Ofgem's regulation of the energy supplier market;
- perspectives on the current resilience of the energy supplier market and issues for customers; and
- the risks and challenges facing energy suppliers in the short and longer term, including the role they should play in supporting the achievement of net zero.

12 The following energy suppliers attended:

- British Gas;
- EDF Energy;
- E.ON Energy UK;
- Good Energy;
- Octopus Energy;
- Scottish Power;
- Shell Energy Retail;
- So Energy; and
- Utilita Energy.
- In addition, we received a written submission from Bulb Energy.

Document review

13 We reviewed publicly available documents for information relating to our key audit questions, including:

- Ofgem consultation papers and related submissions about the price cap, financial resilience and the SOLR process;
- Business, Energy and Industrial Strategy Committee transcripts and submissions for its inquiry into 'Energy pricing and the future of the Energy Market' opened in December 2021; and
- Ofgem guidance, including on enforcement and the SOLR process.

14 We also reviewed published and unpublished documents from Ofgem and the Department. These documents included material relating to the:

- basis and conditions of the Department's sponsorship of Ofgem;
- introduction of the price cap and its impact on suppliers and customers;
- changes to the rules on new and existing supplier resilience in 2019 and 2021 respectively;
- options and risks considered by Ofgem and the Department about the special administration of Bulb Energy;
- monitoring of the retail energy market and suppliers; and
- lessons Ofgem is learning and changes it is making to its regulation of the energy market.

15 We reviewed these documents to track and explain Ofgem's and the Department's past decisions on the price cap, financial resilience and SOLR; understand the impacts for suppliers and consumers; understand how Ofgem and the Department have handled the failure of energy suppliers since summer 2021; and understand what lessons have been learnt and action being taken in response. We also used our document review to triangulate our findings from other sources, including interviews and data analysis.

Data analysis

16 We reviewed Ofgem data and published data including:

- supplier entries and exits in the domestic energy retail market from 2003 to 2022 to understand the growth in the market and extent of later supplier failures. Prior to 2014, net entries and exits do not always match the reported change in total suppliers for the same period. This is because data for 2003 to 2014, 2016 to 2021 and 2022 were prepared on different bases and may not be directly comparable;
- Ofgem's estimate of the total mutualised cost of winter 2021-22 supplier failures, under current mutualisation rules, as at May 2022, to understand the scale of the cost of SOLR being passed on to energy consumers;
- Ofgem's breakdown of costs in the domestic dual fuel bill for a direct debit customer on the price cap between winter 2018-19 and winter 2022 to understand the impact of supplier failures on overall bill increases for consumers; and
- the wholesale price of gas paid by suppliers, compared with gas price assumptions in the default tariff charged to consumers, February 2021 to April 2022, to show the lag between suppliers paying for energy, and then passing those costs or savings on to consumers on default tariffs.

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