



Making a positive difference
for energy consumers

To all interested parties

Email: supplier@ofgem.gov.uk

Date: 29 October 2021

Dear Colleague,

Last Resort Supply Payment claim (LRSP) process

The purpose of this letter is to set out and invite comment on the changes we are proposing to the process for a Supplier of Last Resort (SoLR) to make a claim for a Last Resort Supply Payment (LRSP, often referred to as a "levy claim"). We are making these changes as we recognise that the current market conditions are extremely challenging. We want to work collaboratively with suppliers and the wider industry to ensure that the SoLR process can continue to protect consumers.

In support of this, our proposals seek to clarify the types of costs SoLRs may seek to recover, and to expedite the process in order to facilitate faster payment to SoLRs. We consider these changes will ensure that we and the wider industry are best placed to respond to the current market challenges. Our process is aimed at ensuring we can continue to act quickly to appoint a SoLR to supply all affected customers when a supplier exits the market, and to protect domestic customers' credit balances.

We have set out in more detail in the annexes to this letter how the current claim process works, and the changes we are proposing, given the current market conditions. We will continue to monitor market conditions closely and if necessary may propose further changes to those outlined in this letter.

We welcome the continued cooperation of suppliers and the wider industry, who we have been working closely with in recent weeks to ensure consumers are protected.

I would welcome your thoughts on the process set out in the annexes to this letter. Please send any responses either in writing by 5 November 2021 or, if you would like to meet bilaterally, I would be happy to accommodate this. I would also be happy to facilitate a working level discussion between the relevant colleagues. We are committed to ensuring the SoLR arrangements can continue to operate effectively, in the interests of consumers.

Yours sincerely,

Neil Lawrence
Director of Retail

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Annexe 1

What can be claimed for via the LRSP

The gas and electricity supply standard licence conditions allow a supplier acting as SoLR to make a claim for any reasonable additional, otherwise unrecoverable, costs they incur.¹ The licence also sets out that the Authority will consider all the circumstances of the case when deciding on a claim. We have previously published guidance that provides further information on how Ofgem will assess levy claims.

Historically SoLRs have claimed for the following categories of costs:

- Customer credit balances
- Working capital
- Operational costs (including customer service, IT, complaints/enquiries specific to the SoLR, onboarding costs, communication costs)

The SoLR process is competitive. We expect suppliers to put forward their best bids, reflecting the value to them of the customers they will gain. Each levy claim is assessed in its merits, depending on its particular terms and circumstances and the criteria we use is set out in Annex 2.

The current situation

In assessing what costs are reasonable for the SoLR to recover the licence requires us to consider **all the circumstances of the case**. This means that we will consider the prevailing market conditions at the time when the costs were incurred. We appreciate that the current market conditions are exceptional and suppliers' ability to act as SoLR may be dependent on their being able to make claims on the levy. In particular, at the moment, we expect SoLRs to claim for their otherwise unrecoverable wholesale costs (ie the difference between the wholesale costs that they incur and the wholesale costs that they recover from their customers) and we note that claiming for such costs is permitted under the licence.

The licence sets out that when purchasing energy SoLRs are required to take all reasonable steps to make such procurements as economically as possible. We welcome the commitments SoLR's have made so far to do this whilst recognising how challenging this can be given current market conditions. We further recognise that a significant proportion of any LRSP is likely to relate to commodity costs in addition to the categories that have historically been claimed for, and we are grateful for the cooperation SoLRs have shown so far in committing to providing an appropriate audit trail of their costs to support any claim for commodity costs.

We recognise that many parties will be interested in understanding how such costs will be treated under the levy process and hope that the information set out in this letter will provide useful clarity on our expectations, to all interested stakeholders.

Timeline – speeding up LRSPs

We appreciate that the scale of additional costs SoLRs may face in supplying energy to SoLR customers under prevailing market conditions are such that receiving some payments more quickly than normal will help support the SoLR process and secure continuity of supply to customers of failed suppliers. We are therefore exploring how levy claims can temporarily be sped up, whilst retaining Ofgem oversight.

To date the earliest SoLRs have begun receiving LRSPs is from around 15 months post appointment, with full repayment occurring around 12-15 months later. We acknowledge

¹ Supply Licence Condition 9 gives suppliers the ability to make a claim, governs what suppliers are able to claim for.

that this is not fast enough given the current situation. While much of the current timelines for LRSP is stipulated across the supply, gas transporter and electricity distribution licensees (see annex 2) and so cannot be easily or quickly amended, we have explored and identified immediate measures we can take to shorten the length of time between a SoLR being appointed and levy payments beginning to be recovered.

These immediate measures involve reducing the length of time it takes 1) for a SoLR to submit a claim and 2) for Ofgem to make a decision on that claim.

Specifically, in the current circumstances, we propose to consider more than a single claim per SoLR. **Providing claims are made, decided upon and received by networks prior to the end of 2021 then payments to the SoLR should commence from April 2022.** In the next steps section I provide more detail on how this process will work, and welcome stakeholder views on what I set out.²³

How a multi claim LRSP process could work

While, in principle, SoLRs could submit multiple claims for each supplier failure we propose that the best approach would be for SoLRs to submit two claims per SoLR: an initial claim and then a “true up” claim.

The initial claim would include costs that a SoLR incurs and can be fully evidenced in the period immediately after appointment, in particular commodity costs. Ofgem is making preparations to promptly conduct an assessment of the initial claim and either approve, reject or suggest an alternative amount. We will engage with SoLRs in respect of those initial claim assessments and publish notice of our decisions. However, given both the extraordinary timescales and the likely sensitive contents of commodity claims in particular, we may not have full consultation before making our decisions.

The SoLR would then either follow the levy claim process again by way of making a second claim after the conclusion of its 6 month appointment or make a subsequent declaration that no such “true up” claim would be needed. Ofgem would then consult on the claim as per the current process.

For the avoidance of doubt, we envisage that such an approach would still mean that the total amount recovered via the levy would not exceed the actual additional reasonable unrecoverable costs incurred. Where, in the intervening period between initial claim and a final claim, the SoLR’s costs had reduced, we would expect that to be offset through the second claim/declaration. To support this and mitigate the risk of overpayment, we expect the initial claim to only include costs that have actually been incurred, and so be primarily comprised of wholesale costs. At the second “true up” claim stage, the other cost categories (outlined above) would be claimed for in addition to any further wholesale costs incurred that had not been included in the initial claim, as well as declaring any reduction since the initial claim.

We consider that this approach would mean that the most likely scenario would be that, on approval of the second “true up” claim that the SoLR would receive the shortfall between the initial claim and their total reasonable and unrecoverable costs incurred, thereby avoiding the need for Ofgem to recover costs due to overpayment from the initial claim. However, we propose to make any approval of an initial claim conditional upon a binding commitment both to make the subsequent declaration and repay any net amounts with interest. We are also considering new licence conditions to support such a true up.

² This means we will assess claims within the 6 month period that the current SoLR directions stipulate rather than once that direction has expired which is the current process

To facilitate this process we will need to act agilely and in doing so recognise that being collaborative will be important and we are committed to this. As such we continue to encourage dialogue so all interested parties can keep us informed of impacts and any issues associated with our proposed approach and where stakeholders consider an alternative would better speed up payment and protect consumers, we welcome details of this.

What we would require from SoLRs

We welcome the engagement and collaboration with energy suppliers through these exceptional times. We will continue to look for flexible, practical, ways to operate existing processes and protect consumers. To support this proposed approach, we expect SoLRs to act in accordance with the following general principles/ways of working:

Principle	Explanation
No win / no detriment	SoLRs' claims should represent only the reasonable, additional, otherwise unrecoverable costs they've incurred.
Cooperation and transparency	Cooperation, transparency and collaboration from SOLRs will result in faster processing of claims Such cooperation will be important in order for Ofgem and SoLRs to arrive at solutions that are fair for consumers and work for all parties.
Detailed record keeping	To aid with the above we expect suppliers to maintain internal records that act as an audit trail so that all costs incurred as SoLR are traceable and we expect this to be submitted as part of each claim.
Commitment to audit	Prior to final claims being submitted to Ofgem we will expect all cost categories to be subject to an audit with due rigour that ensures all costs adhere to our criteria in annex 2. We would expect this audit to be signed off by the company secretary and submitted to Ofgem.
Economic and efficient	As per the licence conditions regarding the SoLR process, suppliers must take all reasonable steps to incur costs as economically as possible. This SLC is supported by the operational capability Principle which requires suppliers to efficiently and effectively serve each customer. We set out further details on how this pertains to wholesale costs below.

Wholesale costs

In current circumstances, wholesale costs will be by far the most material cost SoLRs will claim for via the levy. We have therefore, set out in further detail what we expect from SoLRs on wholesale costs at the initial claim stage and explain the approach Ofgem proposes to take to assessing this cost category.

At the initial claim stage, we propose that it would be appropriate to claim for all wholesale costs incurred, including any contracted positions that are balance sheet liabilities but where delivery of the energy may not have yet happened.

We do not propose that the following wholesale costs should be claimed for initially:

- Forecasted wholesale costs that have not been incurred, for instance trades to shape positions closer to delivery that may be forecasted but have not yet been executed
- Costs incurred for the period after March 2022. We are open to considering this issue where SoLRs have indicated they intend to claim for these costs but for now we think that further policy work is required to fully understand the issue. We want

to have discussion with SoLRs on this point and look forward to clarifying it with affected parties.

Furthermore, at either the initial claim stage or in any subsequent claim, we do not consider it appropriate for SoLRs to claim for wholesale costs that exceed the differential between the wholesale costs incurred and the amount that recovered from SoLR consumers. The licence is clear that the only costs that can be claimed for via the LRSP are those that are unrecoverable.

As per the licence, when purchasing energy to comply with its SoLR direction, SoLRs must take all reasonable steps to do so as economically as possible in all the circumstances of the case.⁴ We recognise that in doing so different SoLRs are likely to adopt different hedging strategies and that these strategies will be based on the information they have at the time and each SoLRs best view on how to meet its obligations. We also recognise that given the highly uncertain market conditions SoLRs may have to deviate from their normal practice in order to fulfil their obligation to purchase energy as economically as possible, and that a SoLRs ability to follow its desired strategy may be limited by factors out with its control, such as market liquidity.

To support us to make such an assessment we will use the following criteria.

Criteria	Our expectations
Wholesale strategy	<ul style="list-style-type: none"> • SoLR has stated its wholesale strategy for purchasing energy in relation to SoLR customers and provided justification that it is reasonable based on the information available and prevailing market conditions when the strategy was executed, including: <ul style="list-style-type: none"> ○ Explaining any deviations from the wholesale strategy and costs anticipated at bid. ○ Explaining any deviations from its normal wholesale strategy. ○ Where relevant, explaining how they have, and will continue to, otherwise minimise costs, for example through leveraging any existing arrangements which allow them to flex existing volumes to meet the demand of their SoLR customers in the most economical way.as far as possible
Implementation of strategy	<ul style="list-style-type: none"> • We will check whether trades undertaken reflect the stated strategy. • We will assess the reasonableness of underlying assumptions including on volumes and churn rates, given market conditions faced when strategy was implemented.
Claim does not include costs we do not consider appropriate to include in an initial claim	<ul style="list-style-type: none"> • We will check that costs in the initial claim are only for those wholesale costs incurred for the period of the SoLR's appointment until end of March 2022 and do not include any costs related to costs not yet incurred.⁵

⁴ SLC 8.8: *If the licensee purchases gas/electricity to comply with a Last Resort Supply Direction, it must take all reasonable steps to do so as economically as possible in all the circumstances of the case*

⁵ Costs that fall out with this criteria will be considered further in subsequent true up claims.

Assessment of costs	<ul style="list-style-type: none"> • We will check the prices against the bid-offer spread on the relevant day to ensure that they match the prices in the SoLR's claim and that the contracted volumes match those set out in the SoLR's wholesale strategy.
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As set out in the general principles, to enable Ofgem to make its assessment of reasonableness we propose to require SoLRs to maintain comprehensive, coherent and clear records. In particular for wholesale costs, we propose exhaustive records of:

- all relevant trades and positions
- churn rates
- any trades that reduce the cost to serve

We propose to engage directly with the SoLR and may ask for further information or supporting evidence at either initial or subsequent claim stages.

Further considerations and next steps

LRSPs are paid for by the relevant electricity and gas distribution networks. For gas distribution networks (GDNs), the deadline for them to receive a valid claim in order to pay SoLRs during 2022/2023 or as soon as practicable in the 2023/2024 regulatory year is 31 October 2021. We have been engaging with GDNs on this issue and they have confirmed a willingness to receive claims after the 31 October. Claims received after this deadline, could be reflected in the GDN's annual revenues for 2022-2023 as set through the Annual Iteration Process. The effect of which is that the deadline for them to receive approved claims becomes mid-late December.

The relevant deadline for electricity distribution networks (DNOs) is 31 December. Where an amount is above their materiality threshold, provided these DNOs give notice within 28 days of receiving a valid claim and we grant them any necessary derogation, they will be able to raise their charges from next April.

We are aware that this would mean network charges are likely to rise significantly from April next year. Although all consumers benefit from the orderly market exits which the SoLR process provides, we appreciate the negative impact this will have on consumers and, possibly, suppliers remaining in the market. We are therefore exploring how to mitigate this impact and would welcome discussion with stakeholders on this.

Annex 2 – how Ofgem assesses current levy claims

Our main methodology criteria for assessing whether a SoLR levy claim is reasonable in all circumstances of the case are as follows:

- **Additional:** whether the costs claimed are additional to the costs to the SoLR of serving existing customers. In addition, we consider whether these costs would have been expected at the time of the SoLR's bid and whether any commitments were given in relation to these costs in their competitive SoLR bid.
- **Directly incurred as part of the SoLR role:** whether the costs were incurred as a result of taking on customers in an emergency situation as opposed to normal customer acquisition routes. It would not be appropriate for us to allow the SoLR to claim for costs they would have incurred through a normal acquisition route.
- **Otherwise unrecoverable:** whether the SoLR could have recovered the costs through other means. It would not be appropriate for us to allow the SoLR to claim for costs it could have recovered through the administration process or customer charges, for example.
- **Economic:** whether the SoLR had made all reasonable efforts to avoid the cost in the first instance or absorb the cost.

Annex 3: LRSP timelines

#	Stage	Timeline	Defined by licence?
1	SoLR makes LRSP claim	Usually 6-9+ months post SoLR appointment but backstop is within 5 years of direction. This letter sets out temporary scope for earlier claims in some circumstances.	No – the licence does not specifically stipulate when SoLRs have to submit their claims. Existing timelines have been dictated by when SoLRs have felt it prudent in line with provisions in licence for what SoLRs are permitted to claim for
2	Ofgem assess and approve the LRSP claim	3-6 months following receipt of claim. This letter sets out temporary scope for faster assessment of initial claims.	No – the licence stipulates the tests (outlined above) that the Authority must give to claims but does not stipulate specific timeline
3	Gas networks pay the SoLR the LRSP	12 months starting from April 2022 or April 2023 if valid claim received by some by 31 October 2021. This letter notes the steps we are taking to extend this timescale. ⁶	Yes – Special Standard Condition A48.4 sets the timeline
3	Electricity distribution networks pay the SoLR the LRSP	If below materiality threshold – between 3 and 15 months after they receive valid claim If above materiality threshold – the following April if valid claim received by DNO by 31 December and DNO has given notice within 28 days of receiving the valid claim and Ofgem has granted any necessary derogations	Yes – Standard Licence Condition 38B.3 sets the timeline Standard Licence Conditions 38B.9 and Clause 19.1B of DCUSA
4	Gas networks raise charges to recover LRSP cost	12 months starting from the next April if valid claim received by 31 October – i.e. no lag between payment and recovery	Yes – Special Standard Condition A48.3 sets the timeline -
4	Electricity distribution networks raise charges to recover LRSP cost	If below materiality threshold – in line with Allowed Pass Through Items: 2 years later If above materiality threshold: from 1 April if valid claim received by 31 December and DNO has given notice within 28 days of receiving the valid claim and Ofgem grant any necessary derogation	Yes – Special Condition CRC 2B Standard Licence Condition 38B.9 Clause 19.1B of DCUSA

⁶ IE if a claim is received on 11 October 2021 then the claim would be paid from 1 April 2022 but if the claim is received on 11 December 2021 then the claim would be paid from 1 April 2023

