



Making a positive difference
for energy consumers

To all interested parties

Email: supplier@ofgem.gov.uk

Date: 1 December 2021

Dear Colleague,

Last Resort Supply Payment claim (LRSP) process

On 29 October we published a letter¹ setting out the temporary 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). The purpose of this letter is to summarise the responses we received and set out how we will proceed.

We received 20 responses to our letter from domestic and non-domestic suppliers, gas and electricity network operators and Citizens Advice. Of these:

- 14 gave support or qualified support for our proposal
- 1 respondent said the SoLR process is not appropriate for the current circumstances in the market
- 2 recognised that there is a need to act swiftly given the current market conditions but raised concerns over the possible impact of our proposal particularly on non-domestic consumers and suppliers
- 3 did not give a clear view either way.

Having considered all the responses and in light of the broad level of support we received, and our continued view that we need to make the temporary changes we set out in our letter to maintain the SoLR process and protect consumers through the current extreme market conditions, we intend to proceed with our proposal.

Therefore, unless they waived their right to claim on the SoLR levy, we invite SoLRs that have been appointed since 1 September 2021 to submit claims for costs they have incurred in supplying SoLR customers under their Direction(s) by 0900 on 6 December for Ofgem to review. We aim to decide upon these claims by Friday 17 December. This will enable networks to reflect levy claims in their charges from April and repay SoLRs from May. SoLRs who are unable to make this deadline can still submit claims, however we cannot guarantee that they will be approved by the required deadline for recovery next year.

¹ <https://www.ofgem.gov.uk/sites/default/files/2021-10/20211026%20Letter%20to%20suppliers%20on%20faster%20claims%20final.pdf>

In annex 1 to this letter we set out in further detail the points raised by respondents, both for and against our proposal and our view of these. In annex 2 we set out the key information on the timing for the faster levy process and how we will assess claims.

We continue to welcome the collaborative approach industry has taken with Ofgem during this time to protect consumers. Should stakeholders have any concerns I would be happy to facilitate conversations so we can discuss these.

Yours sincerely

Neil Lawrence
Director of Retail

Annex 1 – consultation responses and our views

Overall views on proposal

Respondents gave a range of views on the central component of our proposal: allowing multiple claims for each SoLR with the initial claim being made and decided upon in order for approved claims to be recovered and paid from April 2022. Nearly all stakeholders, even those opposed to our proposal recognised the urgency and need to act to protect consumers at this time given the current extreme market conditions.

Stakeholders that were against or provided qualified support for our proposal argued that we need to limit the application of our proposal to SoLRs appointed since September only and we should only allow SoLRs to make two levy claims rather than multiple. Some stakeholders who were supportive (either fully or qualified), argued that our proposal would be helpful but was not sufficient due to initial claims still taking up to 18 months to be fully repaid which puts particular strain on SoLRs' working capital requirements. These stakeholders also argued that we should allow for multiple claims rather than restricting SoLRs to two.

Two stakeholders also argued that the proposal will not have a meaningful impact for SoLRs appointed too late to submit a claim in time for the December deadline.

Our view

With regards to whether our proposal is sufficient to meet the challenges presented by the current market conditions, we have sought to balance the needs of all stakeholders and to target interventions that we can make immediately, and without a licence change, given the urgency of the situation.

We considered making further changes to the SoLR levy process including bringing forward payment to the SoLR of approved claims and speeding up payment to the SoLR to less than 12 months. However, such reforms would require licence changes and we would be required to follow the statutory process governing licence changes. Therefore, we concluded such changes would have taken too long to make an impact on the current situation. Furthermore, changes that would allow costs to be recovered in less than 12 months would likely have an even greater impact on consumer bills, network companies and other suppliers and so would require more detailed analysis.

We accept that our proposal will not speed up claims for SoLRs appointed too late to submit a claim prior to the deadline on 6 December. However, this is not a reason for us to not take action where we can now and we consider our proposal will make a meaningful impact for SoLRs appointed this Autumn and as such will ensure consumers are supported through the current crisis.

As we set out in our letter, the faster claim process that we have designed will only be used to support SoLRs during the current extreme market conditions, meaning SoLRs appointed from and including 1 September 2021. We will communicate to industry when we no longer consider it necessary to use this process and when we can revert to the former single levy claim process.

On the issue of multiple claims or two claims; it remains our preference that SoLRs submit two claims as firstly, this is proportionate and more efficient for all parties involved and secondly, allowing more than two claims per SoLR will not, in most instances, speed up repayment any further. This is because any claims made after December 2021 that Ofgem approves prior to the network deadlines in 2022 will not start to be repaid to the SoLR 2023-2024. Therefore even if a SoLR were to make

multiple claims throughout 2022 that Ofgem were to approve, they wouldn't get repaid faster. There may be some limited instances where a SoLR needs to claim more than twice and where this occurs, we will consider on a case-by-case basis whether this is warranted and appropriate in all the circumstances.

Consumer impact

Regardless of whether respondents were in favour of our proposal or not, nearly all respondents highlighted the potential impact our proposal will have on consumer bills, in particular that if we proceed to accept claims ahead of 31 December then the cost of paying these will pass through to consumers on Standard Variable tariffs from April next year. Stakeholders raised options for how to mitigate this impact including spreading the recovery of this year's levy claims over more than a single year and calling on government intervention.

Stakeholders also raised the possible impact on non-domestic suppliers and consumers. Stakeholders argued that many non-domestic consumers have a preference for fixed term tariffs, even in the current market conditions, and as such suppliers won't be able to pass levy costs through. This could result in further market exits or, if suppliers are able to pass through levy costs to their non-domestic customers, this could contribute to the failure of businesses. Stakeholders also argued that the majority of the levy costs will be for wholesale costs that suppliers cannot recover due to the price cap. Since the price cap only protects domestic consumers, these levy costs should only be recovered from domestic consumers (ie the levy should be allocated to the relevant market sector).

Our view

We recognise that this is a difficult time for consumers who will face higher energy costs from April 1 when the price cap increases to reflect the current high wholesale price. We are considering the mitigations suggested by stakeholders. We note that our temporary process will help ensure 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.

The issue of the non-domestic sector paying for costs arising from the domestic sector is specific to gas. In electricity DCUSA mod 332 passed in 2019 and the effect of this is that levy costs are allocated to domestic tariffs only.² Ofgem is reviewing UNC modification 687 which would deliver a similar outcome. This modification has been prioritised and it is now being actively considered. We are aware that there is a timing issue as, should it be approved, the decision would need to be made with sufficient time given for subsequent changes to industry systems to be made.

Networks

Gas and electricity network companies are critical to the SoLR levy process by virtue of them paying the SoLR and recovering the costs of this through their charges. Network companies raised a number of concerns with regards to our proposal.

Standard Special Condition A48

This condition sets out the SoLR payment and recovery process for gas distribution network operators (GDNs) and specifies a 31 October deadline for them to receive a valid claim in order to pay the SoLR from the start of the following regulatory year. In

² Bad debts arising from non-payment of charges in relation to SoLR levy costs are still recovered from all consumers, both domestic and non-domestic

our letter we set out that GDNs had confirmed to us their operational ability to accept claims received after the 31 October deadline. In their responses GDNs highlighted their need for clarity as to the regulatory impacts of their agreeing to an alternative deadline by which they would receive valid levy claims and the need for this to be addressed adequately before accepting claims. They also highlighted the importance of any alternative date not putting them at risk of financial distress.

Contagion concern

Networks highlighted two potential causes of contagion that could result in DNOs and GDNs being adversely affected. The first was if there be a mismatch between networks paying SoLR costs and recovery of these. DNO respondents highlighted that as claims will exceed the materiality threshold for levy claims set out in the electricity distribution licence, they would need to be granted a derogation in order to raise their Use of System charges in April 2022 to enable them to recover the cost of the levy concurrently with paying it to the SoLRs. DNOs also sought assurance from Ofgem on timings of issuing such a derogation. The second was in relation to the accountancy treatment of levy claims. Some network respondents highlighted the potential risk to them should these be accounted for as a liability but the corresponding collection of charges are not accounted for as a receivable. They stressed the impact this could have on networks' credit ratings and reiterated that changes to the SoLR process should not risk further market contagion by placing networks in a position of financial stress.

Our view

We recognise the concerns of networks and address each below.

- Standard Special Condition A48: We confirm that we have requested the GDNs to accept claims received after 31 October 2021 in order to preserve the SoLR process which we consider vital to protecting consumers through the current extreme market conditions by supporting suppliers to fulfil the role of SoLR and ensure continuity of supply. Therefore, we do not consider it would be in consumers' interests to enforce SSC A48 with respect to GDNs including approved levy claims received in December 2021 in network charges from 1 April 2022. Therefore, we will not take enforcement action against network companies for processing claims received after 31 October 2021 as if they were received before 31 October 2021.
- Contagion: We understand the importance that networks, as providers of critical infrastructure, should not be impacted financially by virtue of fulfilling the role of providing the pass-through mechanism for SoLR levy costs. We also recognise that the scale of claims means that the materiality threshold in the electricity networks licence will be breached. It is our minded-to position to grant DNOs the required derogations so that there will be no misalignment between paying the SoLR and recovering the cost of this. We will continue to work collaboratively with DNOs to ensure these derogation decisions provide sufficient time for them to raise charges with due notice. On accountancy treatment of levy claims we have been working with networks to fully understand their and their auditors' concerns and we will continue to collaborate to ensure this process is fully understood by relevant auditors such that networks are not adversely affected.

Should stakeholders have any concerns with our minded-to position with regards to granting DNOs a derogation under SLC 38B of the distribution licence we would invite them to raise this with us no later than 8 December.³

³ And SLC 39B for the relevant DNO

Overpayment and transparency

Five respondents specifically raised concerns that our proposals could result in overpayment to SoLRs. These stakeholders raised a number of possible causes of overpayment including:

- SoLRs using the levy process to subsidise trades for their existing book
- speeding up claims could result in a reduction in quality of these claims and a lower evidential barrier on costs which in turn would result in overpayment
- Ofgem pays SoLRs for risks not identified in the SoLR bid but subsequently identified in the claim
- a lack of consultation at initial claim stage means interested stakeholders cannot offer insight or challenge which results in overpayment.

Stakeholders recognised that Ofgem is mitigating the risk of overpayment through a binding commitment from SoLRs to repay any overpayment at the second claim stage, but one stakeholder raised concerns over the practicalities of this process, calling for it to be in place ahead of signing off any initial claims. Another stakeholder wanted the true up to be underpinned by new licence conditions to ensure any bad debt risk to networks is mitigated.

Our view

Ensuring that we only approve claims for the evidenced costs incurred by SoLRs is our priority. We have designed this faster levy claim process to protect both consumers directly affected by supplier insolvencies and all consumers who will have to pay these costs. As such we are taking steps to mitigate the risk of overpayment:

- we have stated our preference to SoLRs that, at the initial claim stage, they only claim for their additional, unrecoverable wholesale costs incurred. In the event that the amount of costs that were included in this initial claim fall, for whatever reason, the costs claimed in the second claim should be enough to offset this.
- we will be undertaking a robust assessment of claims using the wholesale framework as set out in our original letter and copied below in annex 2.
- our wholesale assessment criteria (see annex 2) includes our expectation that SoLRs should seek to minimise their wholesale costs both for initial claims and second claims
- we will consult on the second claims (including any true-up) and will require SoLRs to provide detail on whether, and if so, how costs have changed since their initial claims. Where there is a net reduction in the costs covered by the initial claim they must also show how they would offset this in their second claim.
- we are developing a binding commitment for SoLRs to repay any overpayment should it not be possible to offset this against the second claim and we will consider any potential future licence modification to further support any repayment.

As a result, it is our view that the risk of overpayment is small. Regarding consulting on the initial claim, there is insufficient time for us to do this and publish a decision ahead of the 31 December deadline for networks to receive a valid claim. Furthermore, since wholesale costs incurred in relation to SoLR customers are likely to be the most substantive element of initial claims, and the relevant details are highly commercially sensitive, they are not amenable to consultation. Through our open letter and this response we have consulted on our approach to assessing those costs and we will require that all costs are fully evidenced and carefully scrutinised, applying all the relevant criteria (see annex 2) to ensure they are subject to a robust assessment. In addition, we will be carrying out a consultation at the second claim stage to further mitigate any risk of overpayment earlier in the process.

Wholesale costs

Three suppliers argued that Ofgem should allow for unrecoverable wholesale costs incurred after March 2022 to be claimed for via the levy. These suppliers stated that the wholesale observation window for the summer 2022 cap period (April-Sep) began in August 2021 and so if a SoLR is appointed after this point they will not be able to align with the price cap methodology. However, a different respondent argued that the levy should only be used until March whereafter the price cap will adjust and another argued that wholesale costs are not necessarily unrecoverable in the longer term as the price cap adjusts to reflect the higher wholesale prices.

More generally on wholesale costs, some supplier respondents argued that Ofgem should take account of the current extreme conditions and allow deviation from established wholesale strategies if there is good reason. Furthermore, one respondent argued that Ofgem should limit its test of "reasonableness", specifically that it would put too much uncertainty on SoLRs if we were to assess the reasonableness of the SoLR's underlying assumptions rather than restricting our assessment to whether deviations from the strategies the SoLR said they'd undertake in their bids are reasonable.

Our view

With regards to wholesale costs post March, in their responses SoLRs have made arguments as to why they should be able to recover these costs. As we set out in our original letter we remain open to this but consider that Ofgem needs to fully assess the merits of these arguments in light of market prices and the level of the price cap post-March which is as yet unknown. We also recognise that SoLRs were appointed more than 6 months before the end of March 2022. Their 6-month direction therefore expires prior to that date.

We consider the two issues are related, since in both cases it could involve consideration of costs beyond the 6-month SoLR directions for which there is no precedent. Therefore, in the New Year we will give these issues due consideration and consult with stakeholders. In the meantime, in the initial claim we will consider costs for the 6 months of the SoLR Appointment, or up to the end of March 2022 whichever is earlier.

More generally on wholesale costs, as we set out in our original letter, we recognise that the current market conditions are highly uncertain and SoLRs may need to deviate from existing strategies for instance due to market liquidity. We also recognise that assumptions underpinning strategies (eg on volumes and churn) will be based on imperfect information. The criteria we set out in our original letter and copied below in annex 2 continues to be what we will use to assess wholesale costs; it is of the utmost importance that SoLRs provide full and clear explanations of their strategies and any deviations they felt were appropriate to make.

Audit

Stakeholders were generally supportive of our position that levy claims should be subject to an audit with due rigour. Respondents queried whether this should be an internal or external audit, particularly for second claims.

Our view

The scale of expected levy claims that will ultimately feed through to consumer bills means that SoLRs submitting claims must maintain a clear and comprehensive audit trail of all costs and commit to working transparently with Ofgem. This plays a key role in assuring us as to the quality of the evidence that is provided and to enabling us to carry

out a robust assessment of all claims. With regards to auditing, the timelines that we are all working to may preclude SoLRs from engaging with an external auditor for initial claims. We do not intend to make it a condition of approval that initial claims are subjected to an external audit but we would expect these claims to go through each company's internal audit and assurance function such that the company themselves are confident that the costs claimed for are accurate and limited to the additional and unrecoverable costs incurred.

With regards to second claims we will communicate further as to whether we will require these to be subjected to an internal or external audit.

Other cost categories

One supplier argued that non-wholesale related cost categories such as credit balances and other costs should be eligible for initial claims.

Our view

It remains our preference for SoLRs to only claim for additional wholesale costs in their initial claim, as these are likely to be the most material cost that is incurred immediately after the SoLR's appointment. Furthermore, as set out in our original letter, where in the intervening period between initial and second claims, costs have reduced – which although possibly unlikely we still consider to be a possibility – in our view, any reduction could be able to be offset from these avoiding the need to pursue other forms of recovery.

However, SoLRs may claim for any costs reasonably incurred, subject to the normal consent process under the licence and providing that they provide justification and evidence that they meet the above criteria. For credit balance costs this means that the credit balances need to have transferred to the SoLRs and have either been credited to customers' accounts or have been refunded. SoLRs should also be aware that, given the need to assess claims at pace, if we have any uncertainty over the costs claimed we would be unlikely to approve them. However, this would not prevent SoLRs from seeking to claim for these costs again at the second claim stage providing additional supporting evidence which we could then assess against the relevant criteria and in accordance with our procedures.

Annex 2: overview of faster levy process

Overview of process

Stage	Timing
SoLRs appointed	From 1 September 2021
SoLRs makes initial levy claim	No later than 9am on 6 December
Ofgem assess initial levy claims	6-17 December
Approved initial claims sent to networks (Authority consents)	17 December
Networks start recovering cost of initial levy through increased charges	From 1 April 2022
Networks start paying SoLRs	From May 2022
SoLRs make second levy claims	Summer/Autumn 2022
Ofgem assess and consults on second levy claims	Summer/Autumn 2022
Approved second claims sent to networks	Prior to 31 October 2022
Networks finish paying initial claims and start paying second claims	April 2023
Networks finish paying second levy claims	April 2024

Overview of levy cost assessment framework

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, nor would it be appropriate to allow **forecasted** wholesale 'shaping' costs given these have not yet been incurred.
- **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 – or reasonably be expected to recover - 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.

General principles we expect SoLRs using the faster process to adhere 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.

Criteria for assessing wholesale costs

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	<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.⁴

⁴ Costs that fall out with this criteria will be considered further in subsequent true up claims.

include in an initial claim	
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.