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

Email: supplier@ofgem.gov.uk

Date: 23 June 2022

Dear colleague,

Last Resort Supply Payment Claim for ScottishPower Energy Retail Limited

On 6 December 2021, ScottishPower Energy Retail Limited ("ScottishPower") submitted for our approval an initial claim for a Last Resort Supply Payment ("LRSP" or "levy payment"). A final version of that claim was submitted on 16th December, and Ofgem consent being granted on 17th December 2021.

This letter sets out our notice of reasons to consent to ScottishPower claiming for a LRSP of up to **£2,377,284.47**. Our decision will allow ScottishPower to recover some of the additional unrecoverable wholesale costs they face in serving customers of Entice Energy Supply Limited ("Entice").

We are approving this initial claim under the temporary procedures we have implemented in response to the current extreme market conditions[1] and with due regard to Ofgem's principal objective of protecting the interests of current and future energy consumers,[2] the relevant provisions of ScottishPower's gas and electricity supply licences[3], Ofgem's "Guidance on supplier of last resort and energy supply company administration orders" (our "Guidance")[4], the terms of the Last Resort Supply Directions (LRSD)[5] and the particular circumstances of the case.

Having scrutinised the evidence ScottishPower has provided (see below), we are satisfied that the amount we have approved is reasonable in all the circumstances of the case. Our approval of ScottishPower's claim is conditional on:

a) ScottishPower entering into the 'True Up' Agreement with us; and

b) complying with any directions we make about the instalments by which the approved amount will be repaid.

Under that True Up Agreement, ScottishPower will submit full details, including any reconciliation of all of its costs once they are fully incurred and known. We expect Scottish

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[1] On 29 October 2021 we set out our proposals for temporary changes to the SoLR levy process to cater for the current unique market circumstances and we confirmed these changes in a letter on 1 December (see: Letter to suppliers on faster claims and Decision letter on supplier of last resort levy claims) These changes allow SoLRs to submit more than a single claim per SoLR Direction and set out further

[2] s4AA Gas Act 1986 and s3A Electricity Act 1989

[3] in particular, SLCs 8 and 9

[4] Supplier of Last Resort: Revised Guidance 2016

[5] Supplier of Last Resort Directions | Ofgem

Power to obtain an independent audit of those full details and board sign off before making any further claim. If there is any reduction in these costs, we will set them off against ScottishPower's subsequent claim. In the highly unlikely event that the subsequent claim is not sufficient for that set off to be made, ScottishPower will agree to repay any net overpayment back to consumers.

An overview of ScottishPower's initial claim together with the reasons for our decisions with respect to this claim are set out in subsequent sections of this letter. This should not be taken as setting a precedent for any future claims, which would also be considered on their merits and on a case-by-case basis, taking into account all relevant circumstances of the particular case.

The SoLR process and the Licensing Framework

Under SLC 9.1 of the Supply Licence, licensed suppliers are entitled, provided the Authority consents, to make a claim for a Last Resort Supply Payment ("LRSP") from each Relevant Gas Transporter and Electricity Distribution Operator.

SLC 9.4 sets out the approach that we adopt when assessing the claim in order to ensure the total amount of the LRSP does not exceed the difference between the total costs incurred by the licensee in supplying customers under the SOLR Direction (taking account of any sums paid or debts assumed by the licensee in relation to Customer Credit Balances) and the total amounts recovered by the licensee through Charges for that supply.[6]

SLC 9.6 makes clear that the Authority may determine that an amount other than the one calculated by the licensee is a more accurate calculation of the relevant amount and in such cases, the amount specified by the Authority must be treated as the relevant amount when the licensee submits its claim to each relevant electricity or gas network licensee under SLC 9.8.

Levy claims are paid for by the relevant gas distribution networks (GDN) and electricity distribution network operators (DNOs), who then recover the cost through charges. SLC 38B of the Electricity Distribution Licence and Standard Special Condition A48 of the Gas Transportation Licence set out the details of this.

Our decision letter[7] sets out how we are working with networks to support the faster levy process and ensure they are not impacted financially. This includes our minded-to position to grant derogations to DNOs to enable them to recover the cost of the levy concurrently with paying it to the SoLRs.

Temporary SoLR process

Under our temporary procedures, we have decided that more than one claim can be made for costs incurred. Our expectation is that this will comprise of an initial claim followed by a true up claim.[8] To mitigate against the risk of overpayment, we expect the initial claim only to include costs that have actually been incurred and can be fully evidenced in the period immediately after appointment, and so comprise, in particular, commodity costs.

[6] SLC 9.4 provides that: 'The total amount of the LRSP must not exceed the total costs (including interest on working capital) reasonably incurred by the licensee in supplying gas to premises under the SOLR Direction and a reasonable profit, plus any sums paid or debts assumed by the licensee to compensate any Customer in respect of any Customer Credit Balances, are greater than the total amounts recovered by the licensee through Charges for the Supply of Gas to premises under the Last Resort Supply direction (after taking all reasonable steps to recover such Charges'.
[7] [Decision letter on supplier of last resort levy claims | Ofgem]
[8] We recognise there may be some limited instances where a SoLR considers it 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

The procedures then provide for a prompt assessment of the initial claim resulting in Ofgem either approving or rejecting it or determining an alternative amount.

We have engaged with SoLRs in respect of these initial claim assessments, analysed them carefully taking account of all the relevant criteria (see further below) and published a notice of our decisions.

As ScottishPower's initial claim is comprised solely of wholesale costs, the relevant details are highly commercially sensitive including details as to the hedging and procurement strategies adopted by ScottishPower. As such, they are not amenable to consultation. However, through our open letter and our decision letter published on 1 December 2021, we have consulted on our approach to assessing those costs including that all costs are fully evidenced and carefully scrutinised and all the relevant criteria are applied to ensure they are subject to a robust assessment.

We set out in more detail below the process we have followed and the criteria we have applied in assessing this claim.

Overview of ScottishPower's claim

In this initial claim ScottishPower is seeking to claim solely for their initial additional and unrecoverable wholesale costs incurred in procuring energy to comply with the Last Resort Supply Directions we issued in respect of acting as SoLR for former customers of Entice.[9]

Table 1 below summarises the total amount claimed and approved.

Table 1: summary of ScottishPower's claim and amounts we have approved

	Amount claimed	Amount approved
Wholesale energy	£2,435,245.72	£2,377,284.47
Total	**£2,435,245.72**	**£2,377,284.47**

To assess ScottishPower's costs, we followed the following process:

- a quantitative check of ScottishPower's methodology for the costs claimed. This included determining how those costs were calculated based on the data ScottishPower sent us and ensuring these costs were in line with commitments ScottishPower made at the time of its SoLR appointment;
- undertaking validation of assumptions made, with other data sources, where appropriate;
- a qualitative assessment of the claim against our methodology criteria.

We set out below further details on the approach we took to assessing these costs and the rationale for disallowing certain costs.

Our assessment of the amount to approve: decision process and methodology

Wholesale commodity costs

Scottish Power requested our consent to claim £2.44m for the additional cost of purchasing energy on the wholesale market to serve former Entice customers. Scottish Power provided evidence to support the amount claimed. The evidence provided was assessed in line with the expectations we have set out in our 1 December decision letter[10] and included:

[9] This is allowed under standard licence condition 8.8.
[10] Decision letter on supplier of last resort levy claims | Ofgem

- an outline and justification of the wholesale hedging strategy it pursued, including how this was and would continue to be efficient;
- evidence of all trades executed in implementing its strategy;
- assumptions made underpinning its strategy; and
- methodology to support its calculation of the portion of the costs faced in procuring energy which would be unrecoverable.

We disagreed with elements of the methodology ScottishPower used when determining the value of its wholesale claim specifically regarding costs that could be recovered via price cap allowances. We therefore disallowed £0.06m, which reduced the amount approved to £2.38m.

Given the highly sensitive and confidential nature of these costs and our statutory duties, we cannot disclose company-specific information relating to those costs. However, we can state that in assessing their wholesale costs we calculated the difference between the total costs and what could be recovered through charges. We were satisfied that ScottishPower's claim related solely to these unrecoverable costs.

To satisfy ourselves that the costs claimed were economic, we carefully reviewed Scottish Power's assumptions behind the volumes it procured and compared the costs that Scottish Power evidenced it faced, with prices that were available in the market at the time, before deciding that we were satisfied that the costs claimed were reasonable in this respect.

To satisfy ourselves that the costs claimed had been incurred, we reviewed the evidence provided in order to confirm that the claim aligned with the expectations we set out in our December letter. This included confirming that ScottishPower had only claimed for the wholesale costs of energy which would be delivered within 6 months of being appointed SoLR or by 31 March 2022, whichever date was earlier.[11] This also involved checking whether the claim included any forecasted wholesale 'shaping' costs because at the time of the claim such costs would be forecasted and so would not yet constitute "costs incurred".

Recovery of LRSP claim

ScottishPower will be paid the amounts specified in the gas and electricity consents given on 17 December 2021 published alongside this letter, by the relevant Gas Transporter and Distributor. This will be recovered by the relevant GDNs and DNOs, allocated in proportion to the total number of nationwide gas and electricity supply points. We consider this apportionment to best enable broad socialisation of the claimed costs in line with the intent of the SoLR regime to protect all consumers in the market, for example, through limiting the extent of unpaid industry bills of a failing supplier.

Yours faithfully,

Neil Lawrence
Director of Retail

[11] The level of the price cap beyond 31 March 2022 was not known at the time