

## Decision on the last resort levy claims true-up process

Subject	Details
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When an energy supplier fails, Ofgem may appoint a Supplier of Last Resort (SoLR) for their customers. There is an industry process in place which enables a SoLR to seek to recover additional costs they face in supplying these customers (known as a 'Last Resort Supply Payment' or the 'SoLR levy'). From 23 June 2022 to 4 August 2022 we consulted on our proposed approach to reflecting the costs suppliers faced in supplying customers of the large number of energy suppliers that failed in late 2021, and which it may be appropriate for them to seek to recover from the levy.

Following consideration of the responses we received to our consultation, this document sets out our decisions on the issues we consulted on in our June consultation. It also describes the next steps.

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## Executive summary

1.1. The unprecedented rise in gas and electricity prices since August 2021 has put energy markets under severe strain, contributing to a large number of supplier failures during the latter part of 2021. Where a supplier fails, Ofgem has the power to intervene and appoint a new supplier to act as a 'Supplier of Last Resort' (SoLR) for customers of the failed supplier.

1.2. The Last Resort Supply Payment (LRSP) process (known as the 'SoLR levy' or 'the levy') is the "backstop" industry arrangement that enables a supplier to seek to recover the additional and unrecoverable costs that they reasonably incur when acting as a SoLR.

1.3. During winter 2021/22 we introduced a number of changes to the levy process which were designed to ensure that the SoLR process continues to protect consumers in the current market conditions. The changes included the temporary introduction of a faster, multiple-claims levy process whereby SoLRs are able to submit more than one claim per supplier. This involves SoLRs submitting an 'initial claim' for costs faced in serving SoLR customers (typically wholesale commodity costs) in the period immediately after appointment. SoLRs may then follow this claim with an additional claim (or claims) after the conclusion of its 6-month appointment. We refer to these additional claims as "true-up" claims. The true-up process is intended to reconcile costs submitted by suppliers with the initial claims, and determines what final payments should be made to them.

1.4. In line with our faster, multiple claims process, by December 2021 we had consented to SoLRs making initial levy claims totalling £1.83 billion. At the time, we set out that we would give further due consideration to a number of issues and consult with stakeholders before assessing subsequent claims by SoLRs who have submitted initial claims.

1.5. On 23 June 2022, we issued a consultation seeking views on our 'minded-to' positions on the fair approach to reflecting the costs suppliers faced in providing energy to customers after being appointed as a SoLR between September 2021 and December 2021. We received nine responses from organisations including suppliers, a consumer group and a network company. Of the responses received from suppliers, all were from suppliers who we expect to submit true-up claims later this year.

### Wholesale costs

1.6. In our consultation, we presented four options we considered to allow, if appropriate, the recovery of additional, unrecoverable wholesale costs that have been reasonably

incurred (Table 1, below). The minded-to position we put forward was to implement Option 2, as we considered this to provide the best balance between the risk of adverse impacts on current consumers (by allowing a longer recovery period in relation to which suppliers can claim costs), and the risk of adverse impact and costs to future consumers, should our approach act as a disincentive on suppliers to act as SoLRs in future.

*Table 1 - The options we considered to allow, if appropriate, the recovery of additional, unrecoverable wholesale costs that have been reasonably incurred*

<b>Option 1</b>	Limit recovery to the cost of energy delivered within six months of being appointed <sup>1</sup>
<b>Option 2</b>	Limit recovery to the cost of energy delivered by the end of March 2022, or within six months of being appointed, whichever is later.
<b>Option 3</b>	Limit recovery to the cost of energy procured within six months of being appointed and which will be delivered by the end of September 2022.
<b>Option 4</b>	Limit recovery to the cost of energy that will be delivered by the end of September 2022.

1.7. In response to our consultation, we received support for our minded-to position from a consumer group, on the basis that options three and four would mean customers bearing normal risks that should fall to the supplier. A number of suppliers did not agree with our minded-to position. Comments received focused on our assessment of how costs are passed onto consumers via the levy compared to other mechanisms, the impact on prudently-hedged suppliers, and the timings of energy delivery versus actual cost exposure.

1.8. Having considered the responses, our decision is to proceed with Option 2. This provides the best balance between the risk of adverse impacts on current consumers by allowing a longer recovery period in relation to which suppliers can claim costs, and the risk of adverse impact and costs to future consumers. This option will lead to a small increase in consumer bills across 2023/24 versus limiting the period of recovery to six months (see analysis in Appendix 1: Impact Assessment).

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<sup>1</sup> This would limit recovery to energy delivered during the 6-month SoLR direction, which for some suppliers ends before the Summer 22 price cap adjustment. This would be consistent with the approach to our assessment of final claims that we took in our assessment of initial claims.

1.9. We consider it to be consistent with our stated policy intention of no-gain/no-detriment through acting as SoLR during a challenging period. It will support the future efficacy of the SoLR regime and overall protect the interests of existing and future consumers.

### **Financing costs**

1.10. In our Consultation we clarified our expectation of the standard of evidence suppliers must provide in relation to financing cost claims submitted through the SoLR levy process. Specifically, we set out our minded-to position that we will require SoLRs to demonstrate and provide evidence that any financing cost they seek to claim delivers value for money to customers (and was the best possible rate they could have achieved given their individual circumstances).

1.11. In response, we received broad support for the principle that SoLRs should be required to demonstrate that their claim delivers value for money for consumers. A number of suppliers who responded to our consultation did not agree with the proposed approach, including one respondent who believed that the requirements place an additional test on SoLRs that was not part of the original process, and another who queried our approach to assessing what constitutes reasonable rates of finance.

1.12. Our decision is to proceed with our minded-to position. We will require suppliers to demonstrate, with evidence, that their financing cost claim delivers value for money for consumers, and was the best possible rate they could have achieved given their individual circumstances.

1.13. We recognise that circumstances differ from supplier to supplier and therefore, for the purposes of this SoLR levy decision only, we are not seeking to mandate that suppliers consider certain financing options nor are we publishing benchmark rates. The onus will be on suppliers to demonstrate that they took reasonable steps to secure the best possible rate in the context of their individual circumstances.

### **Prepayment Meter (PPM) Credit Balances**

1.14. In our consultation we stated that it is reasonable to allow SoLRs to make a case to claim the costs of traditional PPM credit balances through the levy, where these are otherwise unrecoverable. All respondents to this consultation question agreed with our position and we will proceed with this approach.

1.15. We also consulted on a proposed methodology for estimating traditional PPM credit balances as no data would be available for these costs. We received broad support for this approach, although some respondents suggested changes to the methodology.

1.16. Having considered the responses, our decision is to proceed with the methodology we set out in our Consultation. We will expect any claim for traditional PPM credit balances to be based on the percentage of the SoLR's portfolio of smart PPMs with a credit balance on the day of customer transfer, and the average credit balance of those customers at midnight on the day of customer transfer.

1.17. Any claim to recover costs associated with traditional or smart PPM credit balances will be subject to all circumstances of the case and will be assessed against our existing criteria for SoLR levy claims.

### **Audit requirements**

1.18. The minded-to position we put forward in our Consultation was that SoLRs must have all claims independently audited by internal auditors, in accordance with the standards we set out in our Consultation Document.

1.19. Some suppliers expressed concern about our expectations around timing of the audits, raising concerns that there may be insufficient time to complete an audit by the deadline for submitting claims. Having taken all responses into consideration, we will still expect SoLRs to submit their final audit report at the same time as they submit their final claim, due by 7 October 2022.

### **Temporary mitigation measures**

1.20. During winter 2021/22 we introduced a number of changes to the levy process which were designed to ensure that the SoLR process continues to protect consumers in the current market conditions. This included the temporary introduction of a faster, multiple-claim levy process which was intended to reduce the time taken for suppliers to submit claims and for us to make decisions on those claims.

1.21. In our Consultation we proposed that we will seek to end that temporary process as soon as possible after winter 2022/23 and revert to the previous, single-claim process. We received strong support for this approach from a consumer group and a network, but several suppliers did not support this, based on the benefits to suppliers of the multiple-claim process and that market uncertainty is likely to continue into 2023.



1.22. We continue to see benefits in ending the temporary, multiple-claim, levy process as early as possible after winter 2022/23 in order to reduce the risk of overpayment and lessen the short-term impact of levy claims on energy bills. However, any decision to revert to the previous, single-claim, process will depend upon our assessment of the market conditions at the time.

**Next steps**

1.23. Suppliers will be required to submit any true-up claims by 7 October 2022. For each claim, we intend to publish our minded-to position on whether to consent or not, by end October 2022. We intend to publish our final decisions on claims in December 2022.

## 2. Introduction

### Context and related publications

2.1. The unprecedented rise in gas and electricity prices since August 2021 has put energy markets under severe strain. Wholesale market volatility means that energy suppliers have faced increased challenges in managing the risks of buying energy for their customers. This contributed to a large volume of supplier failures towards the end of 2021, requiring us to intervene and appoint a new supplier (referred to as a 'Supplier of Last Resort' (SoLR)) for customers whose energy supplier had failed.

2.2. In carrying out this role, SoLRs incur additional costs which they may not be able to recover through normal cost recovery routes.<sup>2</sup> The Last Resort Supply Payment (LRSP) process (known as the 'SoLR levy' or 'the levy') is the "backstop" industry arrangement that enables a supplier to seek to recover the additional and unrecoverable costs that they reasonably incur when acting as a SoLR. This includes the reasonable costs incurred in purchasing the gas or electricity needed to supply these customers at short notice.<sup>3</sup>

2.3. In normal circumstances, and under the competitive process we follow to appoint a SoLR, the SoLRs may be expected to waive some or all of their right to make claims on the levy. Our preference is for a SoLR to absorb the costs of acting as a SoLR, or if they do choose to make a claim, to minimise the costs, as ultimately these costs fall to all consumers.

2.4. Recent market conditions have resulted in appointed SoLRs seeking to make claims on the levy for the additional and otherwise unrecoverable costs they have faced in supplying the customers of the large number of suppliers that failed in late 2021. As with the normal claim process, we would still expect suppliers to make reasonable efforts to avoid these costs, or absorb them where possible. We acknowledge the higher costs suppliers have faced under recent market conditions, but we are also very conscious of the challenges faced by customers at this time. We expect suppliers to consider the ultimate

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<sup>2</sup> In assessing whether a claim is reasonable, we need to consider 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.

<sup>3</sup> In purchasing any additional gas or electricity to supply newly acquired customers the SoLR is required to do so as economically as possible under the circumstances.

impact on consumers' bills should they choose to make claims on the levy, and we will take that into consideration when making our decisions on claims.

2.5. During winter 2021/22 we introduced a number of changes to the levy process which were designed to ensure that the SoLR process continues to protect consumers in the current market conditions. The changes included the temporary introduction of a faster, multiple-claims levy process which enables SoLRs to submit an initial claim for costs faced in serving SoLR customers (typically wholesale commodity costs) in the period immediately after appointment. SoLRs may then follow this claim with an additional claim (or claims) after the conclusion of its 6-month appointment. We refer to these additional claims as "true-up" claims. The true-up process is intended to reconcile costs submitted by suppliers with the initial claims, and determines what final payments should be made to them.

2.6. In line with our faster, multiple claims process, by December 2021 we had consented to SoLRs making initial levy claims totalling £1.83 billion. At the time, we set out that we would give further due consideration to a number of issues and consult with stakeholders before assessing subsequent claims by SoLRs who have submitted initial claims. On 23 June 2022, we issued a consultation seeking views on our 'minded-to' positions on the fair approach to reflecting the costs suppliers faced in providing energy to customers after being appointed as a SoLR between September 2021 and December 2021. The consultation sought views on the following areas:

**Wholesale costs:** we set out our analysis and minded-to position that claims for wholesale costs should be limited to the cost of energy delivered by the end of March 2022, or within six months of being appointed, whichever is later.

**Financing costs:** we set out our expectations in relation to the evidence that we will require to demonstrate that the financing costs claimed provide value-for-money and are reflective of the true cost faced.

**Traditional PPM Credit Balances:** we set out our position on how levy claims for traditional Prepayment Meter (PPM) credit balances should be treated and sought stakeholder views on the proposed proxy for quantifying the value of a traditional PPM credit balance.

**Audit Requirements:** we set out our expectation that SoLRs should have all claims independently audited and signed-off by internal (or, where relevant, external) auditors. We also set out Agreed Upon Procedures that internal audits will be required to meet.

**Temporary mitigation measures:** to reduce the risk of overpayment and lessen the short-term impact of levy claims on energy bills, we proposed ending the temporary process as early as possible after winter 2022/23.

2.7. In this decision document we summarise the responses received for each question and set out our decisions on how to proceed.

### Related publications

2.8. Related publications are set out below:

Consultation to which this response document refers:

<https://www.ofgem.gov.uk/publications/last-resort-levy-claims-true-process-consultation>

Open letter on introducing a faster, multiple-stage process for making Last Resort Supply Payment (LRSP) claims:

<https://www.ofgem.gov.uk/publications/letter-suppliers-supplier-last-resort-levy-claims>

Letter confirming temporary changes proposed in the above:

<https://www.ofgem.gov.uk/publications/decision-letter-supplier-last-resort-levy-claims>

Revised guidance on the Supplier of Last Resort process (2016):

<https://www.ofgem.gov.uk/publications/supplier-last-resort-revised-guidance-2016>

## Our decision-making process

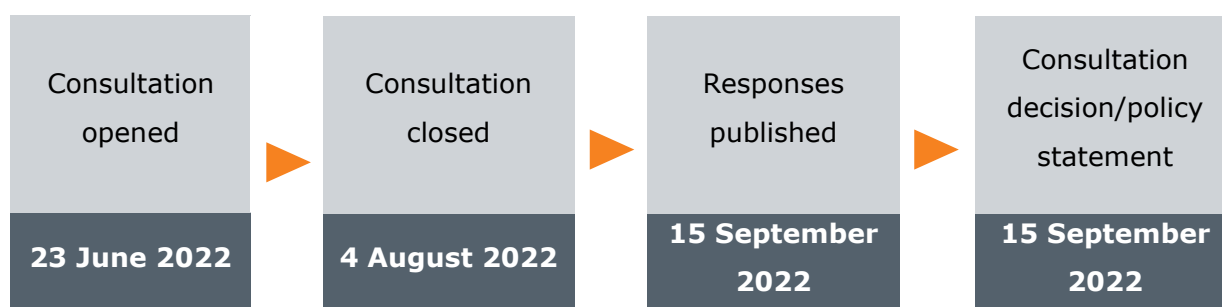
2.9. As described above, we launched our consultation on Last Resort Supply Payments and the 'true-up' process (the "June Consultation") on 23 June 2022. The consultation closed on 4 August 2022 and we received nine responses. We received seven responses from suppliers, all of whom acted as SoLRs during 2021-22 and whom we expect to submit true-up claims. The remaining two responses were from a consumer group and a network company.

2.10. Of the nine responses received, six were non-confidential (or the stakeholder provided a non-confidential redacted version of an otherwise confidential response), and three were confidential. The stakeholders who provided non-confidential responses are listed in Table 2, below.

Table 2 - Non-confidential responses

Organisation	Type
Citizens Advice	Consumer Group
Centrica	Supplier
SP Energy Networks	Network Operator
Utilita	Supplier
E.ON	Supplier
EDF	Supplier

Figure 1: Decision-making stages



## Your feedback

### General feedback

2.11. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments?

Please send any general feedback comments to [supplier@ofgem.gov.uk](mailto:supplier@ofgem.gov.uk).

### 3. Wholesale cost claims

#### Section summary

In this section we set out our decision to allow SoLRs appointed during the period September – December 2021 to apply to recover additional and otherwise unrecoverable wholesale costs incurred relating to energy delivered up until 31 March 2022 or until the end of their 6-month SoLR direction, whichever is later. We consider this to be the fairest approach, which balances the increased cost to existing consumers of allowing a longer recovery period, against the risk of adverse impact and costs to future consumers, should our approach act as a disincentive on suppliers to act as SoLRs in future.

**June consultation proposal 1:** all SoLRs appointed in the period from September – December 2021 should be able to recover additional and unrecoverable wholesale costs reasonably incurred relating to energy delivered up until 31 March 2022 or until the end of their 6-month SoLR direction, whichever is later (option 2)

## Decision Summary

### Stakeholder responses

3.1. We received eight responses to our proposals, with four respondents expressing support for our minded-to position, and four challenging various aspects. We received support for our minded-to position from a consumer group, who stated that prolonging the period of supply for which claims can be made beyond the 6-month period specified in the SoLR direction would mean customers bearing normal risks that should fall to the supplier. We also received comments in support of our minded-to position on the basis that limiting the period during which unrecoverable wholesale costs may be claimed to six months (option 1) could undermine suppliers' confidence in the SoLR process, which would ultimately impact on consumers.

3.2. A number of suppliers disagreed with our minded-to position, with comments focusing on our assessment of how costs are passed onto consumers via the levy versus other mechanisms, the impact on prudently-hedged suppliers, and the timings of energy delivery versus actual cost exposure. These are addressed in more detail below.

## Ofgem response

3.3. We consider our minded-to position (Option 2 in our June Consultation) to be the most appropriate approach, which balances the needs of existing and future consumers. Our decision is to proceed with this approach so that SoLRs appointed between September and December 2021 should be able to recover, if appropriate, additional, unrecoverable costs that have been reasonably incurred relating to energy delivered by the end of March 2022 or within 6 months of being appointed, whichever is the later. In practice, this means that SoLRs who were appointed in September 2021 will be able to recover the reasonable incurred, additional and otherwise unrecoverable costs of supplying energy to SoLR customers through March 2022, up until the summer cap adjustment. In Appendix 1, we have provided an impact assessment which assess the effects and impacts of the SoLR Levy True-Up on consumers, industry participants, government and Ofgem, and the environment.

3.4. This differs from how SoLRs are treated under normal circumstances where, following the six-month<sup>4</sup> direction period<sup>[60]</sup>, customers acquired as part of the SoLR process who remain with a supplier who has acted as their SoLR, are considered to be standard customers. This means that there is a well-established point at which the SoLR should no longer reasonably expect to be able to claim, through the levy, for the costs associated with supplying energy to these customers. In general, any wholesale differential, or other risk that exists when managing customer volumes outside the period of the SoLR direction, should be treated as normal risks that suppliers manage on a day-by-day basis.

3.5. Given the prevailing market conditions, our assessment is that strictly adhering to the six-month Direction for SoLRs appointed during September – December 2021 would not be in the interests of consumers as it could potentially disincentivise suppliers to act as SoLRs going forward, contrary to the interests of consumers in the future. Our decision therefore is to allow SoLRs who were appointed more than 6 months before the Summer 2022 price cap adjustment came into effect, to claim for the costs of delivering energy to SoLR customers, up to the point of that adjustment. We consider this to be a fair and proportionate approach, which serves to minimise the immediate impact on consumers, as well as striking an appropriate balance between the interests of existing and future consumers.

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<sup>4</sup> The Last Resort Supply Direction ('the SoLR Direction') given to a supplier by the Authority requiring it to supply customers of a failed supplier is effective for a period of 6 months from appointment.

3.6. It is important to note that this decision is limited to the particular and exceptional circumstances of SoLRs appointed between September 2021 and December 2021. It is not intended to set a precedent for future SoLRs, which would always be considered on a case-by-case basis, taking account of our principal objective to protect the interests of existing and future consumers. Ofgem must take a principled and fair basis in its assessment of LRSP claims that ensures the best interests of consumers, as well as fairness between suppliers, which it considers Option 2 will best achieve. Nonetheless, we will always consider whether the circumstances of a particular LRSP claim warrant exceptional treatment.

*Options we will not pursue*

3.7. Respondents did not favour Option 1, as there were concerns that suppliers could face financial impacts they had not accounted for. While Option 1 would result in the lowest costs to existing consumers (we estimate it would result in levy costs of around £88m, or £3.10 per consumer bill), we are of the view that it could significantly disincentivise or reduce the competitiveness of future SoLRs, risking adverse impacts and increased costs for future consumers. This is because under Option 1, SoLRs appointed before the end of September 2021 would bear the full cost of the wholesale differential that existed up to the end of March 2022, prior to the Summer 22 price cap adjustment, which would result in them making significant unrecoverable losses during that time. However, once the price cap was adjusted for Summer 22, they would be able to recover these costs. This option would therefore particularly adversely impact the suppliers who were first to volunteer in the crisis to absorb customers early in autumn 2021.

3.8. Four suppliers supported Option 4, which would have allowed SoLRs to seek to claim costs associated with energy that will be delivered during the Summer 22 price cap period. We are not of the view it would be proportionate to apply a blanket extension to allow SoLRs to recover costs via the levy throughout summer 2022. We recognise that some SoLRs may consider there is still a portion of costs they should be able to claim that are unrecoverable. However, we do not consider these costs to be directly related to their role as SoLR, and other suppliers will face similar costs as a result of higher than anticipated volumes of customers remaining on the standard variable tariff.

3.9. Both Option 3 and Option 4 would result in similarly high costs to existing consumers. We therefore consider neither Option 3 or Option 4 to be a proportionate approach when weighing up the costs and risks to SoLRs and consumers, in light of our principal objective to protect existing and future consumers.



*Concerns about the timing of appointment of SoLR*

3.10. It was argued by one supplier that our decision could favour those suppliers that were appointed SoLRs earlier, and who would therefore be able to recover a greater proportion of any differential between wholesale cost allowances in the price cap and prevailing market rates at which suppliers need to hedge. We do not share this view. There were significant differences between prevailing forward prices and price cap allowances at the time of SoLR appointments in late summer/early autumn 2021. To not allow those suppliers that acted as SoLRs early to recover their costs through to the end of March 2022 would risk applying a significant financial cost. Affected suppliers had no meaningful way to avoid these costs at the time. The new price cap which applied from the start of April 2022 meant those SoLRs appointed later did not face the same degree of cost divergence between allowances within the cap and forward prices.

*Costs Incurred / Contracted for that may be claimed against the Levy*

3.11. One supplier raised the point that the focus should be on the period when the costs exposure took place rather than the period when energy was delivered. Generally, our view is that Standard Licence Condition 9.4 requires SoLRs to show that a contractual liability for such costs has arisen during the period of their SoLR Direction, and that the energy (to which those costs relate) has been/will be delivered/supplied to SoLR customers' premises during the period of that Direction. However, we consider that adopting Option 2, which will potentially enable SoLRs issued with a Direction in September 2021 to recover costs for somewhat more than the 6-month period of their Direction, is permissible under Standard Licence Condition 9.4 in the circumstances relevant to this LRSP true-up process.

*Shaping and imbalance costs*

3.12. The options we considered presented differences in the timeframes for which shaping and imbalance costs can be claimed. Options 1 and 3 would limit potential claims to only those shaping and imbalance costs incurred within the 6-month direction period after SoLR acquisition, whereas options 2 and 4 allows for suppliers to claim for costs incurred over a longer period, including for some suppliers the whole of Cap Period 7 (CP7) up until the end of March 2022.

3.13. The actual costs attributable to this cost component will be highly dependent on the approach and strategies used by the SoLR, the size of their SoLR acquisition relative to their market size, and the timing of when they took on their SoLR customers. Suppliers will only be able to seek to claim these types of wholesale costs if they are able to justify and

provide evidence that they have faced additional costs for shaping and imbalance beyond those faced by their non-SoLR customers. As yet, we have seen limited evidence or claims for these additional costs.

3.14. Our approach to shaping and imbalance costs is consistent with our criteria for assessing whether a SoLR levy claim is reasonable, which 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.
- 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 reasonable efforts to avoid the cost in the first instance or absorb the cost.

3.15. Suppliers are already receiving back payments throughout CP8 and CP9 to recoup the additional shaping and imbalance costs faced during CP7. To avoid overcompensating SoLRs through the levy, any SoLR seeking to claim for further incremental shaping and imbalance costs must demonstrate that the costs for their SoLR customers are more than those faced by their non-SoLR customers, for which they are already being compensated for through the price cap.

*Whether our policy should reflect on what was included in SoLR bids*

3.16. When suppliers bid to become a SoLR, they may include certain requests in their bid and ask us to consider them, for example the recovery of costs over a longer period. Three suppliers raised the issue that our decision should reflect what suppliers had included in their bid to become a SoLR.

3.17. When we initiate a competition for the appointment of a SoLR, we issue a Request for Information (RFI) pursuant to Standard Licence Condition 5 of the Electricity and Gas Supply Licences. We use the information provided in the responses to the RFI to inform our decision on the appointment of a Supplier of Last Resort and this therefore should not be

seen as an endorsement of any particular requests that a supplier included in their bid. Our decision takes into account core criteria, such as suppliers having arrangements in place to source the additional gas and electricity required for any customers acquired as part of the SoLR arrangements.

3.18. The supply licences (SLC 9.3 and 9.4) provide that the SoLR would be able to make a claim to recover its reasonable incremental costs incurred in taking on the new customers where those costs are additional to the total amounts recovered from the customers for the supply where it has not waived its right to do so.

3.19. We cannot give assurance, prior to the appointment of the SoLR, as to what costs can be claimed for, or over what period. The onus is on the SoLR to submit a claim that is supported by evidence and demonstrates why the amounts claimed meet the criteria for SoLR levy claims and should be allowed. We will take all relevant information into account in deciding on whether to consent to any claim, or not, given all the circumstances of the case.

#### *Interaction between the Unexpected SVT Demand Allowance and the SoLR Levy*

3.20. Those respondents who disagreed with our proposed approach did so on the basis that at the time of gaining the SoLR they procured energy for Summer 22 in line with expectations in the price cap. It was suggested that in doing so, they faced additional costs relating to the Summer 22 period. While these additional costs may be recovered through the price cap adjustment, those who opposed our position argued that this could lead to under-compensation.

3.21. It was argued that this would occur both because the price cap adjustment is based on a benchmark rather than actual costs, and because when submitting information to enable Ofgem to calculate that benchmark, suppliers were asked to remove SoLR costs which could be recovered through the levy. It would be reasonable to assume that suppliers would only be recovering costs for 6 months, and should have not included SoLR customers beyond that.

3.22. When assessing the potential impact, we used SoLR customer numbers to estimate the amount SoLRs will recover through this mechanism in Cap Period 8 with respect to customers gained through the SoLR process. We assumed that the SoLR customers remain with the supplier over the period of time that the adjustment will be recovered. We did not find evidence to suggest that there might be material under-compensation, over and above what other suppliers might face through allowances based on the benchmark. This suggests

## Decision – Decision on the last resort levy claims true-up process

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that the total SVT adjustment with respect to these customers will be higher than the forecast Levy costs up to end September 22. Therefore, our decision to choose Option 2 should not have a detrimental impact on suppliers.

## 4. Financing costs

### Section summary

This section sets out our decision to proceed with our minded-to position to require suppliers to demonstrate, with evidence, that their financing cost claim delivers value for money for consumers, and is the best possible rate they could achieve given their individual circumstances. We acknowledge that suppliers would benefit from additional clarity and guidance on the approach to take when calculating and submitting claims, and will be issuing templates and guidance in due course.

**June consultation proposal 2:** SoLR to submit claims for financing costs reflective of their actual costs, but we will require SoLRs to further demonstrate, and provide evidence, that their financing cost claim delivers value for money to customers (and was the best possible rate they could have achieved given their individual circumstances).

## Decision Summary

### Stakeholder responses

4.1. We received seven responses to this question. Of those responses, four were largely supportive of the proposals, while two expressed general support but suggested some changes. One respondent stated that they disagreed with the proposed approach.

4.2. Among the respondents who broadly supported the proposals, all considered it appropriate that SoLRs should be required to demonstrate that their claim delivers value for money for consumers. Challenges to the proposed approach included one respondent who believed that the requirements place an additional test on SoLRs that was not part of the original process, and another who queried our approach to assessing what constitutes reasonable rates of finance. A further response called for us to publish our methodology for assessing claims.

### Ofgem response

*Demonstrating value-for-money*

4.3. One respondent expressed concern that the proposed requirements effectively constitute an additional test which was not part of the original bid process, and which suppliers would be unable to now properly or realistically meet retrospectively. We do not agree that this is the case. Under the Supply Licence Conditions<sup>5</sup>, suppliers are entitled to claim for 'reasonably incurred' costs. It is consistent with these conditions for Ofgem to ask suppliers to demonstrate that the costs they are claiming for are reasonably incurred. This includes demonstrating the steps that were taken by the supplier to ensure that the rate secured delivers value for money to customers and was the best possible rate they could have achieved, given their individual circumstances. Without this evidence we could not be satisfied that the costs claimed were reasonably incurred, which in turn would risk excessive costs being passed onto consumers.

4.4. In response to concerns that SoLRs capital costs would now be subject to additional comparison against other SoLRs, and that it would be unreasonable to determine whether or not the stated costs are unreasonable on that basis, we would like to reiterate that, as stated in the Consultation Document, we recognise that circumstances differ from supplier to supplier, hence our decision, for the purposes of this SoLR levy decision only, not to publish 'benchmark' figures. As set out above, the purpose of asking for this evidence is to establish whether suppliers took reasonable steps to secure the best possible rate in the context of their individual circumstances.

4.5. We are not seeking to mandate that suppliers consider third-party financing. While we expect to see evidence that SoLRs have explored the options available to them in order to secure the best rate they could have obtained, we recognise that the options available to suppliers may be limited by a number of factors, including existing arrangements with parent companies/groups. Where existing arrangements have necessitated a certain arrangement, such as an intra-group loan, suppliers should clearly set that out in the evidence and statements provided with their claim.

#### *Rate of finance*

4.6. In assessing what costs are reasonable for SoLRs to recover, the licence requires us to consider all the circumstances of the case, and, as we made clear in our Consultation Document, we recognise that financing costs vary based on the individual characteristics of the supplier. We do not agree that particular rates were agreed as part of the original bid

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<sup>5</sup> Electricity Supply Standard Licence Condition 9.4(a)

process<sup>6</sup> or immediately following the appointment of suppliers as SoLRs, nor do we consider it appropriate to apply a 'one-size-fits-all' benchmark for what represents reasonable interest on working capital.

4.7. It is a clear requirement of the Supply Licence Conditions that any costs claimed for are 'reasonable', and the licence requires us to consider all the circumstances of the case when assessing claims. Suppliers should be able to demonstrate the actual cost of capital that they have incurred as part of the evidence submitted, and we recognise that this may differ from the costs provided when the original bid was submitted. Any claims for working capital costs will be assessed in light of the evidence submitted, as well as the relevant circumstances of the case.

#### *Submitting evidence*

4.8. We agree with comments from suppliers that we should provide as detailed guidance as possible on the evidence we expect suppliers to provide. Accordingly, we will seek to issue standardised templates to suppliers as soon as possible. These templates will include details of the methodology suppliers should follow in calculating their costs and any other information and guidance that may prove useful.

4.9. One respondent suggested we provide template statements for company directors to sign. As the individual circumstances of suppliers are likely to differ greatly, we do not consider it to be beneficial to provide a template letter. It is for suppliers to identify the relevant information and provide this to us in an appropriate form, and a template letter would not allow suppliers to reflect the individual circumstances of their case.

#### *Methodology for assessing claims*

4.10. As set out in our Consultation Document we have committed to publish consultations setting out our minded-to position on whether to consent to each individual claim submitted, which will include details of any claims for financing costs (as far as

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<sup>6</sup> We would not agree at the SoLR selection stage that anything which was, or could potentially be, inconsistent with the provisions in the supply licence. For example, it would not be reasonable to expect that any particular rates of interest could be or were agreed during the bid process. This would fetter the future exercise of our power under the licence to review the amount of any costs claimed against the levy by SoLRs after they had been appointed, and to substitute a different amount than the amount claimed and to only consent to that amount being claimed from the relevant Network companies (SLCs 9.6 and 9.7)

considerations of commercial sensitivity will allow). This will provide interested parties with an opportunity to make any representations to us ahead of us making final decisions on those claims. In order to assist stakeholders in reviewing the claims, we also intend to publish the templates we will be providing to suppliers.

4.11. It is vital that we have a robust process in place to assess claims for financing costs made through the SoLR levy. Given the extremely large sums involved in recent claims, we consider it appropriate to subject claims to careful scrutiny to ensure they are consistent with the principles of the SoLR process and provide value for money for consumers. Accordingly, we will require suppliers seeking to claim from the SoLR levy to demonstrate, with evidence, that their financing cost claim delivers value for money to customers, and was the best possible rate they could have achieved given their individual circumstances.



## 5. Traditional PPM Credit Balances

### Section summary

In principle, SoLRs may seek to make a case to recover traditional PPM credit balances from the levy, where these are otherwise unrecoverable. Any claim to recover costs associated with traditional or smart PPM credit balances will be subject to all the circumstances of the case and will be assessed against our existing criteria for SoLR levy claims.

We consider that the proposed methodology to use SoLRs' existing smart PPM portfolio to estimate traditional PPM credit balances at the time of the customer transfer is the most reasonable approach.

**June consultation proposal 3:** In principle, subject to all the circumstances of the case, Ofgem considers it reasonable for SoLRs to seek to make a case to recover traditional PPM credit balances from the levy, where these are otherwise unrecoverable.

**June consultation proposal 4:** Average credit balances from suppliers' existing smart meter PPM customers are a suitable proxy for a typical PPM customer's credit balance.

## Decision Summary

### Stakeholder responses

5.1. All seven respondents to Question 3 agreed with our minded-to position to allow SoLRs to seek to claim for traditional PPM credit balances. Many of those respondents noted that traditional PPM credit balances would be an unrecoverable cost to the supplier incurred as a direct result as being appointed as SoLR.

5.2. Most of the six respondents to Question 4 broadly agreed with our proposed methodology for estimating traditional PPM credit balances. Some suggested minor changes to our approach, such as utilising a market-wide average of smart PPM credit balances as a benchmark to assess individual claims. One supplier disagreed with our proposed methodology and set out a potential alternative approach that we should take.

## **Ofgem response**

### ***Question Three – Ability to claim for traditional PPM credit balances***

5.3. We consider that, in principle, it is reasonable for Ofgem to allow SoLRs to make a case to claim the costs of traditional PPM credit balances through the levy, where these are otherwise unrecoverable. We recognise that the traditional PPM customers of a failed supplier would have continued to draw down the existing credit on their meter and that a SoLR would have been required to supply this energy without receiving payment. Enabling SoLRs to make a case to claim for these costs will align our position with those for other cost categories and reduce the risk that future SoLRs will not volunteer for failed suppliers with large traditional PPM portfolios.

5.4. We agree that in cases where smart PPMs are not successfully switched into credit mode before customers are transferred the same principle should apply to unrecoverable costs incurred as a direct result of a supplier being appointed as a SoLR.

5.5. Any claim to recover costs associated with traditional or smart PPM credit balances will be subject to all circumstances of the case and will be assessed against our existing criteria for SoLR levy claims. We will expect SoLRs to demonstrate the steps taken to minimise the costs (for example seeking to claim credit balances from the administrator of the failed supplier), and we will decide on a case-by-case basis whether it is in consumers' interests to grant our consent.

### ***Question Four - Methodology for determining the traditional PPM credit balance claims***

5.6. Our consultation highlighted that there would not be any 'real' data available for the SoLR to use in its claim for traditional PPM credit balances and that a method for estimating these balances would be needed. We recognised that an inherent risk with any estimate is that it does not reflect the true cost to the supplier of covering traditional PPM credit balances for the customers it takes on from the failed supplier.

5.7. Our minded-to position in the consultation set out a proposed methodology for estimating traditional PPM credit balances by allowing the SoLR to use the average credit balances of their existing smart PPM portfolio as a proxy for their claim. We considered that setting out a clear methodology for SoLRs to use, supported by robust evidence, should minimise the risk of any overpayment and provide consistency across all claims.

5.8. To assess this proposal for the consultation we reviewed existing Ofgem research and found, through our analysis of indirect proxy measures for credit levels per PPM, that there was no significant difference in these levels between smart and traditional PPM customers. However, we acknowledged that the indirect proxy measures were imperfect and sought stakeholders' views on our minded-to position.

5.9. Data from more recent surveys suggests an emerging trend that would be consistent with smart PPM customers having lower credit balances on average. However, given the small sample sizes from our surveys it is difficult to draw firm conclusions. There could also be other external factors driving these new changes that were not present or as material at the time of supplier failures, such as the rising cost of living. We continue to believe that using smart PPM credit balances as a proxy for traditional PPM credit balances is a reasonable approach due to the lack of available data for traditional PPM credit balances.

#### *Alternative methodologies considered*

5.10. One respondent disagreed with our proposed methodology on the basis that there may be differences in a supplier's customer base that could significantly impact upon their claim amount. For example, a higher proportion of smart PPMs that have been installed to recover debt may lower the average credit balances.

5.11. The respondent proposed that either all suppliers with smart PPM portfolios, or all SoLRs, should be required to submit data to Ofgem on the average levels of their smart PPM credit balances at the time customers were transferred for each SoLR claim. Ofgem could then use a market average based on this data to determine the level of claimable traditional PPM credit balances for each claim. One respondent also suggested that we undertake a similar exercise in order to create a benchmark by which to assess individual claims and examine any claims that are significantly different from this market average.

5.12. We consider that the additional administrative burden on Ofgem and suppliers is disproportionate to the risk that is posed by differences in a SoLR's existing customer portfolio impacting on their claims. It would also not guarantee that the resulting estimate is any more accurate for each individual claim than an estimate based on each individual SoLR's smart PPM credit balances.

#### *Insufficient portfolios of smart PPM customers*

5.13. In circumstances where a SoLR does not have a sufficiently large portfolio of smart PPM customers to undertake a robust estimate of credit balances, one respondent

suggested we use the market average of smart PPM credit balances. As with our view on the alternative methodologies above, we believe that this will place a disproportionate burden on other suppliers in the market. We do not currently expect any true-up claims to include unrecoverable costs of traditional PPM credit balances from SoLRs without a sufficient portfolio of smart PPM customers. However, we may utilise this method of estimating traditional PPM credit balances in any future scenario where a SoLR does not have a sufficiently large portfolio of smart PPM customers to provide a robust estimate.

*Methodology to be used*

5.14. We have decided that the proposed methodology to use SoLR's existing smart PPM portfolio to estimate traditional PPM credit balances at the time of the customer transfer is a reasonable approach. We will expect any claim for traditional PPM credit balances to be based on the percentage of the SoLR's portfolio of smart PPMs with a credit balance on the day of customer transfer, and the average credit balance of those customers at midnight on the day of customer transfer. Where a supplier is claiming for both gas and electricity customers, a separate figure should be calculated for each.

5.15. However, in line with Ofgem's approach to all levy claims, SoLRs will be expected to provide sufficient supporting evidence for the figures upon which the estimate was based. If a SoLR provides evidence that characteristics of its customer base impacts upon the claim it submits for traditional PPM credit balances, Ofgem will take this into consideration when assessing the claim's underlying calculations.

5.16. In addition, Ofgem's process for assessing and consenting to any claim includes a consultation on our minded-to position. This consultation gives other stakeholders the opportunity to present their views as to the reasonableness of a SoLR's claim and enables them to submit any relevant evidence that a claim is not reasonable.

## 6. Audit requirements

### Section summary

In this section we set out our decision that we will require SoLRs to have all claims independently audited by internal auditors, and that we consider the standards set-out in our Consultation Document to be appropriate. We expect SoLRs to submit their final audit report at the same time as they submit their final claim, due by 7 October 2022. We also clarify a number of points around the Agreed-Upon Procedures.

**June consultation proposal 5:** SoLRs should have all claims independently audited and signed-off by internal (or, where relevant, external) auditors. We will only request an external, independent audit if we have serious concerns about any part(s) of a SoLR's claim(s).

### Stakeholder responses

6.1. We received seven responses to this question. Of those, six agreed with Ofgem's minded-to position that claims should be subject to an independent internal audit and one respondent disagreed and suggested an alternative approach.

6.2. Of the respondents that supported Ofgem's minded-to position, one agreed in full with Ofgem's proposals with the others querying some of the practicalities and the timing of the proposals.

### Ofgem response

6.3. 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 us. Prior to final claims being submitted to us we expect all cost categories to be subject to an audit with due rigour that ensures all costs adhere to our criteria. 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.

#### *Application of ISRS4400*

6.4. In the Consultation Document, we stated that auditors should have regard to International Standard on Related Services 4400 (ISRS 4400) – Engagements to Perform Agreed-Upon Procedures Regarding Financial Information. While ISRS 4400 is directed toward engagements regarding financial information, in our view this standard will provide useful guidance for engagements regarding non-financial information, provided the auditor has adequate knowledge of the subject matter in question and reasonable criteria exist on which to base findings.

6.5. We are of the opinion that the Agreed-Upon Procedures (AUPs) we set out in the consultation provide reasonable criteria on which to base the audit findings and therefore consider it appropriate for ISRS 4400 to apply to the internal audit on levy claims. Auditors who do not apply ISRS 4400 should justify their decision and explain the alternative approach they used to demonstrate how the AUPs have been met.

#### *Requirement to use an Internal Audit team*

6.6. We first introduced the audit requirement for final claims in our letter to suppliers on supplier of last resort levy claims dated 29 October 2021<sup>7</sup> and therefore consider that SoLRs have had sufficient time to prepare for this requirement, including ensuring that their internal audit teams have the relevant technical expertise to audit the final claims. We will not accept internal audits that have not been carried out with the necessary independence or in accordance with the appropriate standards.

#### *Treatment of the cost of an external audit*

6.7. In our Consultation Document, we stated that we will only request an external, independent audit if we have serious concerns about any part(s) of a SoLR's claim(s). It is the SoLR's responsibility to ensure that the audit is carried out with due rigour, in accordance with recognised professional standards and covers the AUP. We therefore consider the cost of an additional external audit, should it be requested by Ofgem, to be an avoidable cost. This means that the cost of the audit may not be claimed from the levy, regardless of the outcome.

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<sup>7</sup> <https://www.ofgem.gov.uk/publications/letter-suppliers-supplier-last-resort-levy-claims>

*Timing of the audit*

6.8. In response to concerns that there is insufficient time for suppliers to carry out internal an audit or to procure an external audit, we first raised the audit requirement for final claims in our letter to suppliers on supplier of last resort levy claims dated 29 October 2021<sup>8</sup>, and therefore consider that SoLRs have had sufficient time to prepare for this requirement. As set out above, we will only request an external, independent audit if we have serious concerns about any part(s) of a SoLR's claim(s), including the standard or independence of the audit provided to us.

6.9. Final levy claims must be submitted by 7 October 2022, and we expect SoLRs to submit their final audit report at the same time. We are of the view that SoLRs have had sufficient time to prepare for this new audit requirement and would advise SoLRs that any delay associated with submission of the final audit may put their ability to meet the 31 December 2022 deadline for submission of claims to the networks at risk.

6.10. On 17 August 2022, in preparation for the submission of SoLR final Levy claims for 2021-22 and in advance of a formal Request for Information (RFI), we sent SoLRs, for comment, a draft of our claims submission template for the wholesale element of the claims. This draft template closely follows the format of the template provided by Ofgem when SoLRs submitted their initial claims.

*Migration and financing costs*

6.11. Regarding the request received for further clarity on how migration costs should be treated, the audit requirement for migration costs is the same as the requirement for all costs, i.e. the audit should "confirm that all costs claimed for meet Ofgem's criteria for SoLR levy claims, i.e. they must be additional, directly incurred as part of the SoLR role, unavoidable, otherwise unrecoverable and efficiently incurred and evidence has been provided to support this is efficient."

6.12. Regarding the period over which financing costs may be claimed, we recognise that financing costs will continue beyond the point at which a claim is made to us, and the

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<sup>8</sup> <https://www.ofgem.gov.uk/publications/letter-suppliers-supplier-last-resort-levy-claims>

wording of the AUP is not intended to provide a hard cut-off date for the costs that may be claimed.

### *Claimable Credit Balances*

6.13. Concerns were raised by one respondent over Ofgem’s interpretation of ‘credit’ in the licence and, therefore, what components of a customer’s credit balance are claimable through the levy. For clarity, our interpretation is that credits resulting from incentive payments, Warm Home Discount (WHD) payments<sup>9</sup>, or Guaranteed Standards payments are not normally recoverable via the levy<sup>10</sup>.

6.14. In November 2018, we introduced changes to the Standard Licence Conditions to set out the costs that a SoLR may recover for protecting credit balances. This included a new definition of Credit in SLC 9.10 that refers only to payments made by the Customer for the delivery of energy, taking into account any unbilled gas and electricity consumption.

6.15. In our November 2018 decision, we stated that goodwill payments are discretionary and that it is a commercial decision whether the SoLR chooses to honour any such payments made to the customer for the purpose of managing customer relationships.<sup>11</sup> The Gas and Electricity supply licences do not provide for credit balances which have come about as a result of supplier reward or loyalty schemes to be claimed via the levy.

6.16. This is the position that Ofgem has taken previously in a levy claim for costs related to a failed supplier, which had run a loyalty scheme for its customers.<sup>12</sup> In our decision on that claim, we noted the discretionary nature of these payments made them different to the payments made by customers for the delivery of energy which are explicitly referred to in SLC 9. We considered that these loyalty payments should not, therefore, necessarily be

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<sup>9</sup> Although WHD payment costs are not recoverable through the levy, this does not adversely impact customers who are entitled to WHD payments. WHD payments to Core Group or Core Group II customers will be levelised according to a supplier’s market share through the WHD reconciliation regulations. SoLRs who pay Broader Group payments in Scotland may count the spending against the following year’s obligation, up to a maximum of 10% of their own current year Broader Group obligation.

<sup>10</sup> For payments in Scotland, we set out in our letter [Rising wholesale energy prices and implications for the regulatory framework](#) that since Core Group rebates are to be included within the Core Group Reconciliation Process, suppliers may not claim costs for these through the SoLR levy. Suppliers should in the first instance use the overspend provisions to accommodate additional Broader Group rebates for customers. Levy claims will be considered for rebates paid to eligible customers of the failed supplier(s) for the amount above the permitted overspend

<sup>11</sup> [Decision to modify SoLR supply licence conditions | Ofgem](#) 5 November 2018

<sup>12</sup> [Decision on Last Resort Supply Payment claim from Scottish Power for Yorkshire Energy and Tonik Energy | Ofgem](#) 17 December 2021



covered by a LRSP as we believe that our safety net exists to protect money that customers have paid into their account.

6.17. In this claim decision, we acknowledged that there may be cases where such payments are indistinguishable from credit balances resulting from payments made by customers, and that we may consider it appropriate to cover these costs through the LRSP as they are not able to be separated. However, in the case of that particular levy claim, the Administrator was able to separate out reward payments from customers' credit balances, and this portion of the claim was not consented to.

6.18. This definition of Credit in SLC 9.10 also extends to portions of customer credit balances that are a result of other payments to the customer, such as Warm Home Discount and Guaranteed Standards compensation, as they are not payments made by the customer in relation to the delivery of energy consumption.

#### *Audit of credit balances*

6.19. One respondent noted that a robust audit of credit balances is reliant to a large degree upon the administrator, and they flagged that administrators have not always been co-operative in SoLRs. While we recognise that the audit of credit balances can be reliant upon the administrator's cooperation, we expect to see robust evidence that all reasonable efforts have been made to obtain the relevant information from the administrator(s) involved with the SoLR.

#### *Consultation on the wholesale and financing methodology*

6.20. We have consulted on the high-level principles of our wholesale methodology, and the data we will collect via the RFI that will accompany the final claims reflects the principles of the methodology we consulted on. The draft RFI was shared with SoLRs on 17 August 2022 and will be published shortly after this decision document. In our view, additional consultation on the detail of the wholesale methodology or the financing methodology would delay the submission of the final claims and put suppliers at risk of being unable to submit their claim to the networks by 31 December 2022.

6.21. We therefore will not consult on the detail of the wholesale methodology or the financing methodology. In the interest of transparency, we intend to publish the final wholesale methodology RFI shortly after the publication of this decision document, which stakeholders can refer to when reviewing our minded-to positions on claims.

*Alternative approach to audit*

6.22. One respondent considered an internal audit to be insufficient, given the expected scale of SoLR claims, and suggested an alternative approach where a number of suppliers are selected for audit each year. Given the scale of the expected claims, we consider it appropriate and proportionate for all final claims to be subject to an audit. We maintain our position that an internal, independent audit, carried out to the standards we set out in the consultation document, will provide sufficient assurance. This audit will be reviewed by us, and we plan to only request an external independent audit where we have concerns about any parts of a SoLR's claim or about the standard, or independence, of the audit provided to us.

## 7. Temporary Mitigation Measures

### Section summary

We will seek to end the temporary, multiple-claim, levy process as early as possible after winter 2022/23. This will help reduce the risk of overpayment and lessen the short-term impact of levy claims on energy bills. However, in response to comments highlighting the potential for continued uncertainty in 2023, we are clear that any decision to revert to the previous, single-claim, process will depend upon our assessment of the market conditions at the time.

**June consultation proposal 6:** The temporary, multiple-claim, levy process will come to an end as early as possible after winter 2022/23 in order to reduce the risk of overpayment and lessen the short-term impact of levy claims on energy bills.

## Decision Summary

### Stakeholder responses

7.1. We received nine responses to this question. Five respondents disagreed with Ofgem’s minded-to position, two responses were supportive of it, and two responses did not put forward a clear position on when the temporary, multiple-claim process should come to an end.

7.2. Two respondents were in favour of our minded-to position, pointing to the short-term impact of levy claims on energy bills, and the increased complexity and administrative burden of the temporary process, as reasons to revert to the single-claim process. Respondents who broadly disagreed with our minded-to position cited uncertainty in the wholesale market in early 2023 and the benefits of the multiple-claim process to suppliers as reasons to continue with the multiple-claim process beyond winter 2022/23.

### Ofgem response

#### *Impact on bills*

7.3. We recognise that the multiple-claim process is likely to reduce the overall cost of levy claims (as suppliers’ costs are recovered more quickly). However, it also means that supplier failures will likely have a more immediate impact on consumer bills, as the costs

incurred by suppliers in acting as a SoLR are recovered more quickly from the network companies (and subsequently passed onto consumers). Feedback received from a consumer group and from a network company supports our view that reverting to the single-claim process will lessen the short-term impact of levy claims on energy bills. With bills likely to remain very high into 2023, we consider it important to minimise any additional impact on bills resulting from supplier failures.

7.4. A number of respondents did not agree with our assessment that there is increased risk of overpayment under the multiple-claim process. While we have put in place robust processes to minimise the risk of overpayment at the initial claim stage, we still consider there to be a small risk of overpayment at the point an initial claim is made, due to inherent uncertainties in making a claim at this early stage (although any overpayment would be recovered at the point of the second, 'true-up', claim). In our view, the single-claim process allows for greater scrutiny of claims prior to any payments being made by network companies, minimising the risk of overpayment at the initial claim stage.

#### *Market uncertainty*

7.5. A consistent theme in the responses we received was uncertainty around market conditions in early 2022/23. As we set out in our Consultation Document, any decision to extend the process would need to take into account the broader market conditions. If we consider that market conditions in early 2023 continue to necessitate the multiple-claim process, we will retain the option to continue following that process. However, we believe that when market volatility subsides, the multiple-claim process will no longer be necessary and that it is in the best interests of consumers to revert to the previous, single-claim process. Any decision to revert to the previous, single-claim, process will depend upon our assessment of the market conditions at the time.

## 8. Next steps

### Section summary

This section sets out the key deadlines for suppliers to submit true-up claims and our process for consulting on these claims.

### Submitting true-up claims

- 8.1. Suppliers will be required to submit their true-up claim by 7 October 2022. We strongly recommend that suppliers engage with us ahead of submitting their claims and submit draft documentation to us if appropriate.
- 8.2. During the true-up process we will publish, for each claim submitted, consultations setting out our minded-to position on whether to consent to the claim. We intend to publish these by 28 October 2022 and they will be open for comment until 25 November 2022. The purpose of these consultations is to provide interested parties with an opportunity to make any representations to us, ahead of us making our final decision.
- 8.3. We intend to publish our final decisions on claims in December 2022, ahead of the deadline for suppliers to apply to the networks for their claims on 31 December 2022.

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## Appendix 1: Impact Assessment

### Overarching approach to the draft impact assessment

9.1. This impact assessment aims to identify and assess the effects and impacts of the SoLR Levy True-Up on consumers, industry participants, government and Ofgem, and the environment. We present our analysis of the impact of a set of options we have considered. This analysis has informed our policy decisions relating to the fair approach to reflecting the costs suppliers faced in providing energy to customers after being appointed as a SoLR between September 2021 and December 2021.

9.2. This impact assessment has been conducted in accordance with the Ofgem Impact Assessment Guidance. In developing the impact assessment we have also drawn on HM Treasury Green Book, BEIS and Regulatory Policy Committee (RPC) guidance.

Table 3 - Estimated cost of claims within baseline scenario (option 1)

Metric	Metric	Low	Medium	High
Additional cost of claims already expected within baseline scenario	Total Levy Claim	£3m	£88m	£174m
	Impact on 2023/24 bills	£0.10	£3.10	£6.10

9.3. We have assessed the relative impact of our options against the baseline position that cost recovery is limited to the cost of energy delivered within six months of being appointed as SoLR (option 1 in our analysis above). We estimate that £88m of wholesale costs remained to be claimed through the true-up process in relation to this baseline position. This is the minimum estimated cost of reconciling in the true-up the initial wholesale costs SoLRs claimed for in December 2021 with the final wholesale costs faced.

9.4. As such, for the purpose of this impact assessment, when assessing the impact of the alternatives considered we focus only on the additional impact of the options compared to this baseline.

9.5. Our core analysis covers monetised and non-monetised impacts over the period of the impact wholesale period, from September 2021 until October 2022.

## Impact on consumers

9.6. The temporary multi-claim levy process applies to all suppliers who were appointed as a SoLR between 1 September and 6 December 2021. Under these procedures, claims submitted by 6 December 2021 were reviewed by Ofgem/GEMA by 17 December 2021. SoLRs were then able to begin the process of recovering the amounts we consented to from 1 April 2022, via network companies, who increased their network charges to cover these costs, also from 1 April 2022.

9.7. As part of the true-up process, we expect that any approved additional claims will be added to the winter 2022 claims process, with claims flowing through to bills as from the 1 April 2023 to 31 March 2024. Any increased in claims that follow the recovery route outlined above will impact network charges, and therefore domestic consumer bills from April 2023 – March 2024.<sup>13</sup>

9.8. An estimate of the total incremental levy claims, and their potential impact on bills for consumers between April 2023 – March 2024 is outlined below for our four options.

Table 4 - Estimated Impact of Options on Consumer Bills

Costs	Option	Metric	Low	Medium	High
Options Impact on Consumers	Option 1 (Baseline)	Total Levy Claim	£0m	£0m	£0m
		Impact on 2023/24 bills	£0.0	£0.0	£0.0
	Option 2	Total Levy Claim	£48m	<b>£51m</b>	£53m
		Impact on 2023/24 bills	£1.70	<b>£1.80<sup>14</sup></b>	£1.90
	Option 3	Total Levy Claim	£81m	£119m	£157m
		Impact on 2023/24 bills	£2.90	£4.20	£5.50
	Option 4	Total Levy Claim	£84m	£125m	£166m
		Impact on 2023/24 bills	£3.00	£4.40	£5.80

<sup>13</sup> The licence modifications we introduced in early 2022 to allow for third-party financing of levy claims may help mitigate the immediate impact on consumer bills. If suppliers take up the option of third-party financing of SoLR levy claims, the impact of some of the costs on consumer bills may be spread over a longer period.

<sup>14</sup> Impact estimated based on expected total levy claim, apportioned to UK electricity network accounts as a proxy for households. Total impact apportioned across April 2023 to March 2024.



9.9. The direct financial impact of Option 2 is estimated to increase in wholesale element of the levy claim by £51m (or £1.80 per customer bill), compared to our baseline scenario of the claims we have already received (and expect to receive within the true-up process for this policy option) – i.e. Option 1, limiting all wholesale cost recover to the duration of the 6-month SoLR direction.

9.10. We consider that allowing SoLRs to claim until the Summer 22 price cap adjustment is the appropriate course of action given the circumstances of the case, as outlined in Table 4. While it would result in some additional costs for consumers compared to limiting the claim strictly to 6-months from appointment, it is more consistent with our stated broad principle of no-gain/no-detriment through acting as SoLR during the crisis. In reaching this decision, we have had regard to the matters in s149 (1) of the Equality Act 2010 and do not consider that this decision gives rise to any issues.

9.11. We consider that allowing SoLRs to claim for additional, unrecoverable costs up to the point of the price cap adjustment is in line with broad principle at the time of SoLR appointments that suppliers should be subject to no-gain/no-detriment if acting as a SoLR during the energy crisis, and on balance should represent a fair balance between the risk of adverse impacts on current consumers by allowing a longer recovery period in relation to which suppliers can claim costs and the risk of adverse impact and costs to future consumers.

9.12. We consider it to provide a measured and a proportionate approach to balancing the cost to current consumers of allowing a longer recovery period against the risk of adverse impact and costs to future consumers if our approach acts as a disincentive on suppliers to act as SoLR. It will also mitigate against the risk of overcompensating SoLRs, who are also being compensated through the broader measures introduced for all suppliers to recover costs faced during Winter 21 (outlined in chapter 1).

9.13. In addition, we have considered the potential for other secondary impacts on customers driven by these options. We do not expect there to be any other unintended risks to consumers from the implementation of this policy not already considered. Given we do not expect there be any material detriment to suppliers, we do not foresee any impacts on service quality provided by suppliers, or impacts on quality due to changes in competition.

9.14. Option 2 is estimated to increase the wholesale element of the levy claim by £51m compared to the baseline, at £1.80 per customer bill. We recognise that this increase will have varying impacts on different groups of consumers, including groups that share

protected characteristics. We have considered whether it is likely to impact any groups more than others, taking into consideration the way that these costs are transferred to consumers.

9.15. On 18 August 2022, we published the outcome of our review into the arrangements for recovering the costs of supplier failure from electricity customers<sup>15</sup>. We considered whether the existing fixed charge continued to be appropriate, or if a usage-based (volumetric) alternative would be a more suitable way to recover these costs. We took the view that the benefits of change to the arrangements are relatively limited, and do not represent an effective way of dealing with particular concerns raised surrounding low-income customers, or prepayment customer self-disconnection. We also consider that the impacts on high-consuming customers, particularly where users have greater energy use as a result of vulnerabilities such as disability or health conditions, are not desirable.

### Impact on suppliers

9.16. The key direct impacts of this policy on suppliers will involve the additional transfer of allowances to suppliers from the levy compared to what would occur under the baseline scenario. As part of our analysis, we have analysed the supplier level transfers for our options to each of the relevant suppliers who took on one of the 22 SoLR claims which were submitted within December 2021. For each supplier, we analysed the financial impact at an individual supplier level. The net aggregate flows to suppliers as part of the levy impacts are outlined below.

Table 5 - Estimated Impact of Options on Suppliers (Levy flows to suppliers)

Costs	Option	Metric	Low	Medium	High
Options Impact on Consumers	Option 1	Levy Flows to Suppliers	£0m	£0m	£0m
	Option 2	Levy Flows to Suppliers	£48m	<b>£51m</b>	£53m
	Option 3	Levy Flows to Suppliers	£81m	£119m	£157m
	Option 4	Levy Flows to Suppliers	£84m	£125m	£166m

9.17. Suppliers will have incurred a set of incremental costs driven solely by their participation within SoLR. Our preferred option (option 2) will enable the costs directly

<sup>15</sup> <https://www.ofgem.gov.uk/publications/follow-our-review-arrangements-recovering-costs-supplier-failure>

attributable to delivering energy during the period of time a supplier has been directed to act as a SoLR to be claimed via the levy. Therefore, overall, we do not believe that suppliers will be left materially “out of pocket” because of their participation within the SoLR regime.

### **Other impacts**

9.18. The SoLR Levy process is expected to lead to a direct transfer to suppliers, and an increase in energy bills for consumers within all options analysed, this could impact energy demanded and carbon emissions. We assume within this impact assessment, all other things being equal, that any increase in price could be expected to lead to a decrease in energy usage for these customers, and subsequently of emissions.

9.19. Given the small increase in bill levels (compared to overall energy bills) within the options we have analysed, we expect these increases to be immaterial. We subsequently expect there to be a limited environmental impact of this policy proposal. We also do not expect any potential for other impacts from this policy proposal on government or other industry participants.

9.20. Given that any bill impacts or impacts on supplier finances which we might expect are only a small proportion of overall energy bills expected for 2023/24, we do not expect a material impact on competition. The last resort levy claims true-up policy will only impact a limited number of suppliers who participated within the December 2021 claims process. We believe our proposed policy position fairly compensates these suppliers for participation within the SoLR process. We consider any risk of unintended impacts from our position that could impact the competitiveness (positively or negatively) of suppliers involved to be unlikely.