

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

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4 November 2022

Dear Colleague,

### **Last Resort Supply Payment Claim from Shell**

On 07 October 2022, Shell<sup>1</sup> gave notice to Ofgem of its intention to submit a claim for a Last Resort Supply Payment ("LRSP") "True-up" claim. Shell is seeking to recover additional, otherwise unrecoverable costs incurred in acting as Supplier of Last Resort (SoLR) to the former customers of Colorado Energy Limited ("Colorado").

Under Standard Licence Condition (SLC) 9.1 of the Supply Licence, SoLRs are entitled, provided Ofgem consents, to make a claim for a LRSP from each Relevant Gas Transporter and Electricity Distribution Network Operator. The claim from Shell included its calculation of the claim amount and information to support the calculation (outlined in Table 1).

This letter sets out the reasons why we are minded to consent to Shell claiming a LRSP of up to £1,834,178.92. This total is subject to recalculation of the working capital figure by Shell. Due to deductions made on other cost categories, we are unable to undertake the calculations on working capital to arrive at an allowed amount, but the deductions made in other categories mean that this figure is likely to decrease. We therefore require Shell to resubmit their working capital calculation no later than the end of the day on **Tuesday 08 November 2022**.

Elements of this document have been redacted for publication due to commercial sensitivity.

We are minded to allow Shell to claim for costs incurred in complying with a Last Resort Supply Direction<sup>2</sup> relating to:

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<sup>1</sup> Company Number 00140141

<sup>2</sup> [Direction to appoint Shell Energy Retail Limited as Electricity Supplier of Last Resort to Colorado Energy Limited | Ofgem](#)

- Additional wholesale costs incurred as a result of commitments to supply energy to SoLR customers;
- protecting the credit balances owed to former customers of Colorado;
- financing costs incurred on becoming a SoLR; subject to recalculation of the financing costs element of the claim by Shell.
- any other costs reasonably incurred on becoming a SoLR.

In our policy decision on this true-up process we noted that during winter 2021/22 we introduced a number of temporary changes to the LRSP claim 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. During consultation several suppliers supported continuation of this, based on the benefits to suppliers of the multiple-claim process and the likelihood of continuing market uncertainty into 2023.

As part of that faster multiple-claim levy process, each of the SoLRs entered into a true-up deed with us. Under the True-up Agreement between Shell and Ofgem, Subsequent Levy Claims may be made following the Initial Levy Claim and before a final True-up claim. We are minded to consider this claim to be a Subsequent Levy Claim for the purposes of the True-up Agreement. This would mean that the final True-up claim would happen next year, or in the years after. This will enable suppliers to submit additional LRSP claims with supporting evidence for costs that have not yet been approved by Ofgem and allow Ofgem to ensure the benefit of any monies recovered from the administrators of the failed suppliers can be utilised for consumers' benefit. A result of this is that we may, under the terms of the True-up Agreement, require a final True-up claim to be submitted in future years. In the meantime, we note that obligations under the True-up Agreement continue to apply and will continue to apply after a final True-up claim has been finalised.

We welcome views but are minded to make our consent to this claim conditional on their confirmation that the terms of those true-up deeds continue to apply to this and further claims requested or made in accordance with it. This includes an obligation to submit true-up information as requested and to refund any amounts by which Shell has been overcompensated by a LRSP.

The purpose of this consultation letter is to provide interested parties with an opportunity to make any representations to us, ahead of us making our final decision. We will take such representations into account in our final decision making and may make

changes to our minded to position in response to such representations, if we consider it appropriate to do so.

In addition, before we make our final decision, we will conduct an additional assurance process in respect of the calculations contained in our minded to position which may also be reflected in our final decision.

We expect to make our final decision in mid-December 2022.

## **Background**

### *The SoLR process*

Electricity and gas supply is a competitive activity in Great Britain. While competition has the potential to bring many benefits to consumers, in a competitive market, companies that are not operating efficiently may fail. This applies as much in relation to the gas and electricity supply markets as it does to other markets.

It is Ofgem's statutory duty to protect customers' interests when suppliers fail. When a supplier fails, our focus is to ensure continuity of supply for its customers and to minimise wider negative impacts on the market. These wider effects stem from the fact that if an energy supplier fails, its customers will continue to be physically supplied with gas and/or electricity, but the supplier will not be able to meet the costs of providing this energy. In these circumstances, the costs of procuring the necessary energy will be spread across all domestic suppliers and the costs of procuring gas will fall to the relevant shipper. There is also the real risk that if a supplier fails without urgent intervention, consumer trust and confidence in the energy market would be materially damaged.

Ofgem can ensure continuity of supply to the failed supplier's customers and minimise these wider negative effects by appointing a SoLR, which is issued with a Last Resort Supply Direction requiring it to supply the failed supplier's customers at very short notice<sup>3</sup>.

### *Colorado SoLR event*

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<sup>3</sup> The obligation for a supplier to comply with a LRSD derives from standard licence condition 8 of each supplier's gas and electricity supply licences and is intended to ensure a universal service for Great British energy consumers (for further information on this universal service, see Articles 3(3) of the EU Directives 2009/72/EC and 2009/73/EC).

On the 18<sup>th</sup> of October 2021 we appointed Shell as the SoLR<sup>4</sup> for Colorado gas<sup>5</sup> and electricity<sup>6</sup> customers, following its announcement that it had ceased trading. This followed an appointment process aimed at getting the best deal for consumers. We outline the material factors behind our decision to appoint Shell as the SoLR to those customers in our decision letter, which we will expect to be published this autumn.

### **Claim for Last Resort Supply Payment**

Under SLC 9.1 of the Supply Licence, SoLRs are entitled, with Ofgem’s consent, to make a claim for a Last Resort Supply Payment (“LRSP”) from each Relevant Gas Transporter and Electricity Distribution Network Operator.

SLC 9.4 provides that the total amount of the LRSP must not exceed the amount by which the total costs (including interest on working capital) reasonably incurred by the SoLR in supplying customers under the Last Resort Supply Direction and a reasonable profit plus any sums paid or debts assumed by the SoLR to compensate customers in respect of any customer credit balances plus any additional (actual or anticipated) interest and finance costs associated with a financing arrangement approved under SLC 9.7C are greater than the total amounts recovered by the SoLR through charges for that supply.

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

LRSPs are paid for by the relevant gas and electricity network operators, who then recover the cost through charges to suppliers. SLC 38B of the Electricity Distribution Licence and Standard Special Condition A48 of the Gas Transportation Licence set out the details of this.

### **Our true-up decision process and methodology**

During winter 2021/22 we introduced a number of changes to the process for making LRSP claims, which were designed to ensure that the SoLR process continues to protect

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<sup>4</sup> Link: [Ofgem appoints Shell Energy Retail Limited to take on customers of Pure Planet Limited, Daligas Limited and Colorado Energy Limited | Ofgem](#)

<sup>5</sup> Link: [Direction to appoint Shell Energy Retail Limited as Gas Supplier of Last Resort to Colorado Energy Limited | Ofgem](#)

<sup>6</sup> Link: [Direction to appoint Shell Energy Retail Limited as Electricity Supplier of Last Resort to Colorado Energy Limited | Ofgem](#)

consumers in the current market conditions. The changes included the temporary introduction of a faster, multiple-claims process whereby SoLRs are able to submit more than one claim in relation to each Last Resort Supply Direction.

This involves SoLRs submitting an 'initial claim' for costs faced in serving SoLR customers (typically wholesale commodity costs) in the period immediately after appointment. These initial claims were therefore limited to the recovery of costs for energy delivered within 6 months of their SoLR appointment or up to the end of March 2022, whichever was earlier. SoLRs may then follow this claim with an additional claim (or claims) for any additional and otherwise unrecoverable costs reasonably incurred under their SoLR Direction. We refer to these additional claims as 'true-up' claims for additional costs reasonably incurred that relate to period October 2021 to October 2022. SoLRs entered into a 'True-up Agreement' with Ofgem to support the faster process. Initial claim consents and subsequent true-up claims are conditional on SoLRs meeting the requirements of the True-up Agreement. The true-up process is intended to reconcile suppliers' initial claims with actual costs incurred and determine any additional payments or repayments that should be made.

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 any subsequent claims by SoLRs who 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. A decision document was published on the 21 September 2022<sup>7</sup> that set out our policy decisions on the approaches SoLRs should take with regards to these true-up claims. We have now applied these policies in order to reach our minded-to position on true-up claims.

Under SLC 9.5, Ofgem must decide whether it is appropriate in all the circumstances of the case for the SoLR to make the claim notified to it in accordance with Standard Licence Condition 9.3. If we consider that the claim made by the SoLR is appropriate we will consent to it and the SoLR will be able to lodge a claim with the relevant network operator.

Our process to reach our minded-to position included:

- a. A quantitative check of Shell's methodology for each cost item claimed. This included determining how each total cost item was calculated based on data sent to

us by Shell and ensuring these costs were in line with commitments Shell made at the time of its SoLR appointment;

- b. A “true-up” and cross check of any evidence that may result in a change to the initial claim made by the SoLR;
- c. Undertaking validation of some assumptions with other data sources, where appropriate; and
- d. A qualitative and quantitative assessment of the claim for costs related to credit balances, financing and other in accordance with our criteria and methodology, set out below.

- **Additional:** whether the costs claimed are additional to the costs to the SoLR of 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 all reasonable efforts to avoid the cost in the first instance or absorb the cost.

### Shell claim

Shell indicated at the time of our SoLR appointment process that it would not waive its right to make a claim for LRSP costs for wholesale credit balances, financing costs and certain other costs.

The initial claim was consented to on 17 December 2021. Consistent with the terms of that consent and the True-up Agreement between the SoLR and Ofgem, we have taken that claim into consideration in reaching our minded-to position on this claim.

### **Summary of our minded-to decision**

Based on the information available and consideration of the circumstances in which Shell was given a Last Resort Supply Direction and in accordance with the True-up Agreement in relation to customers of the former Colorado, Ofgem is minded to consent to Shell's claiming a LRSP of up to £1,834,178.92. This total is subject to recalculation of the working capital figure by Shell.

Under the supplier SLCs we are required to consider on a case-by-case basis whether in the particular circumstances of the case, it is appropriate for a SoLR to make a claim for a LRSP. We have set out below our reasons for our minded-to position for this case. 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.

Table 1: Summary table of initial claim, true-up and minded-to position on final claim amounts.

<b>Item</b>	<b>Cost</b>	<b>Initial Claim</b>	<b>True-up claim</b>	<b>True-up deductions</b>	<b>Minded-to position on claim</b>
1	Wholesale	£6,662,018.19	£1,638,001.09	£991,330.63	£646,670.46
2	Credit balances	£0	£468,831.06	£0	£468,831.06
3	Working capital	£0	£709,758.49	£0	£709,758.49
4	Other costs	£0	£77,826.84	£68,907.93	£8,918.91
	Total	£6,662,018.19	£2,894,417.48	1,060,238.56	£1,834,178.92

## **Reasons for our minded-to decision**

### **Cost Category: Wholesale**

In our published decision on the claims true-up process<sup>7</sup> we explained that all SoLRs appointed in the period from September – December 2021 should be able to recover additional and otherwise unrecoverable wholesale costs reasonably incurred as part of the SoLR role relating to energy delivered up until 31 March 2022 or until the end of their 6-month SoLR direction, whichever is later. This has been necessary largely as a result of a period of extreme wholesale energy price volatility and record high prices seen, resulting in wholesale direct fuel costs often far exceeding those assumed in the default tariff price cap

<sup>7</sup> [Decision on last resort levy claims true-up process | Ofgem](#)

over the period. The bulk of these costs were considered in the December 2021 initial claim, by which time most initial wholesale energy purchases had taken place.

In this true-up claim we have analysed the information provided by suppliers, to:

- Assess whether costs being claimed for are consistent with the criteria set out earlier in this letter and our September 2022 Decision on the true up process.
- Assess the reasonableness of assumptions made and decisions taken, including for example demand forecasting and hedging strategies, against the criteria we consider in assessing claims.
- Assess the specifics of the reported wholesale market trades, including trade date, contract type, price, and volume. Specifically, we have considered whether trade prices are consistent with market benchmarks and price assessments.
- Assess cost per MWh and cost per customer to facilitate comparisons between claims.
- Assess the amounts deemed to have been recovered from customer charges, including the applicability of various price cap allowances, and hence offset against the wholesale costs incurred.

The Colorado true-up claim includes £1,638,001.09 in wholesale costs. Following the above assessments, we consider that the claimed amount is not fully consistent with our criteria and we are minded to consent to the claim with the following deductions:

- A deduction of £137,611.64 for the revenue received from SoLR customers in respect of the Backwardation allowances in the price cap. Backwardation allowances were set out in our decision on the potential impact of increased wholesale volatility on the default tariff cap in February 2022<sup>8</sup> (“February 2022 Decision”) and our decision on possible wholesale cost adjustment in August 2022<sup>9</sup> (“August 2022 Decision”). The deduction has been calculated based on a value of £14 per typical dual fuel customer, SoLR customer numbers at the end of winter 2021/22, and the forecast annualised gas and electricity demand of these SoLR customers.

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<sup>8</sup> [Price Cap - Decision on the potential impact of increased wholesale volatility on the default tariff cap | Ofgem](#)

<sup>9</sup> [Price Cap - Decision on possible wholesale cost adjustment | Ofgem](#)



- A deduction of £184,205.12 for the revenue received from SoLR customers in respect of the Contracts for Difference (CfD) Interim Levy Rate (ILR) allowance in the price cap in cap period 7. The deduction has been calculated based on a Demand weighted ILR of £6.88/MWh in cap period 7, multiplied by the claimed electricity supply volume for SoLR customers in cap period 7.
- A deduction of £10,028.26 for the revenue received from SoLR customers in respect of Shaping, forecast error and imbalance, transaction cost and basis risk allowances within the price cap, specifically for volumes in the period covering 17 October to 31 October. This has been calculated for each fuel as the difference between the claimed comparator prices (without allowances) and the prices with allowances, multiplied by claimed demand in the period.

A deduction of £659,485.60 for part of the cost of hedging for which sufficient evidence has not been received. The proposed total deduction is £991,330.63 leading to a net wholesale true-up claim of £646,670.46. When taking into account the initial claims made in December 2021, the total wholesale costs approved would be £7,308,688.65.

Table 2: Summary of claims for wholesale costs

Item	Cost	Initial Claim	True-up claim	True-up deduction categories	True-up deduction amounts	Minded-to position on claim
1	Wholesale	£6,662,018.19	£1,638,001.09	Backwardation	£137,611.64	
				Contracts for Difference	£184,205.12	
				Correct comparator for short-term trading	£10,028.26	
				Incremental cost of hedges for which sufficient evidence has not been received.	£659,485.60	

Note: we are unable to calculate the proportion of the wholesale claim made up of backwardation, CfD, short-term trading and re-hedging. As such, we have shown the deduction above in relation to the overall wholesale claim.

Rationale for decision:

## Backwardation allowances:

In February 2022 Ofgem introduced a retrospective allowance into the default tariff cap to allow suppliers to recover the systematic and unrecoverable backwardation cost for suppliers, beyond the normal basis risk inherent in the cap. An amount of £8 per customer (at typical consumption) was included within the cap for the year starting 1 April 2022, applied via an increase to the additional wholesale risk allowance component of the cap. In August 2022 a further allowance of £6 per customer was introduced, to be recovered in the year from 1 October 2022.

The allowances were based on estimates from suppliers which did not exclude costs incurred specifically for SoLR customers. These allowances will be recovered from all customers, SoLR and non-SoLR<sup>10</sup>. Given this, we consider that the revenues collected by suppliers under this allowance should be deducted from claims made by SoLRs in relation to the costs of hedging SoLR customers' demand subsequent to their taking on the customers of the failed supplier. In other words, the costs of purchasing wholesale energy for these customers should be reduced because suppliers are allowed to recover approximately £14 per customer through higher bills in later periods.

We propose to calculate the relevant deduction for each supplier based on our best view (given the information submitted by the supplier as part of its claim) of (a) the number of SoLR customers that remained with that supplier as of the end of winter 2021/22 and (b) the annualised demand of those customers. We prefer this to an approach based on suppliers' own forecasts of their SoLR customers' demand in the period from 1 April 2022, because the latter approach would result in deductions that are dependent on suppliers' forecasts of future customer numbers. We prefer our proposed approach to an approach based on the number of SoLR customers at the time of appointment, because that approach would not account for the fact that some SoLR customers may have since switched to fixed tariffs or other suppliers which did not take on any SoLR customers in winter 2021/22.

## Allowances for supplier charges in relation to the Contracts for Difference (CfD) scheme:

The default tariff cap relating to electricity customers includes an allowance for costs incurred in relation to the CfD scheme, which is a government scheme aimed at supporting low carbon electricity generation. The charges that suppliers face under the CfD scheme depend on wholesale electricity prices, with higher prices resulting in lower costs (all else

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<sup>10</sup> This is in contrast to the allowance for Unexpected SVT Demand, which did exclude costs related to SoLR customers

equal). The allowance included in the cap is based on Low Carbon Contract Company (LCCC) forecasts of the relevant charges as they exist prior to the cap being set, which are in turn based on forward prices observed at that time of the forecast<sup>11</sup>.

The increases in wholesale prices which followed the cap for winter 2021/22 being set in August 2021 led to SoLRs paying prices for wholesale electricity which were well in excess of the direct fuel allowances included in the cap - this cost has comprised the majority of SoLRs' claims. However, increases in wholesale electricity prices also resulted in CfD costs that were significantly lower than the relevant allowance in the cap.

As we set out in our February 2022 price cap decision<sup>12</sup> on the potential impact of increased wholesale volatility on the default tariff cap, for non-SoLR customers, this benefit was not realised in most cases, as suppliers had hedged their CfD exposure earlier in 2021, when wholesale prices were lower. However, we consider that this is unlikely to apply to SoLR customers. This is because, where a supplier hedged their CfD exposure for SoLR customers, this would have been at much higher wholesale prices given the timing of the SoLRs, locking in a lower CfD cost than included in the cap. And where a supplier did not hedge, they would have realised the outturn CfD cost – which given high Day Ahead wholesale prices would have been a net payment back to the SoLR in question through the CfD scheme.

Given this, to avoid SoLRs over-recovering in relation to wholesale costs of their SoLR customers, we are minded to deduct an amount from claims equivalent to the demand-weighted interim levy rate component of the default tariff cap for period 7, on the basis that the revenue generated under the CfD allowance would have offset the wholesale costs incurred by suppliers. Where suppliers consider that they incurred a CfD cost in relation to SoLR customers, they should provide evidence - setting out the cost incurred versus the allowance included in the cap - and we will take this into account in our final decision.

Short-term trades to cover immediate energy need:

The wholesale claim by Shell includes trades to fulfil SoLR customers' immediate energy requirements, in the period between appointment and the beginning of the next traded month.

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<sup>11</sup> <https://www.ofgem.gov.uk/sites/default/files/2022-06/Decision%20on%20the%20Contract%20for%20Difference%20%28CfD%29%20allowance%20methodology%20in%20the%20default%20tariff%20cap.pdf>

<sup>12</sup> <https://www.ofgem.gov.uk/publications/price-cap-decision-potential-impact-increased-wholesale-volatility-default-tariff-cap>

Shell has claimed for the costs incurred in relation to the immediate requirements of SoLR customers (i.e. wholesale gas and electricity delivered in the period from the date of the SoLR until the end of the month). We consider that it is appropriate for suppliers to claim for these short-term trade costs, however we consider that the offsetting revenue that SoLRs should assume to have been recovered from customers in relation to these costs should include the various wholesale allowances that are included in the cap, not just the direct fuel cost component. This is because we expect only limited further costs to be incurred in relation to these trades. For example, the shaping and imbalance allowance covers costs from season or quarter ahead through to delivery, whereas short term trades will require only limited further shaping. Similarly, limited additional transaction costs would be incurred. We are therefore minded to deduct £10,028.26 from the claim to account for the shaping and imbalance, transactions costs and basis risk allowance amounts not taken into account by Shell when considering revenue recovered from customers for these volumes.

Unexpected demand:

The claim includes the costs of hedging for which sufficient evidence has not been received. For non-SoLR customers, a retrospective allowance was introduced into the default tariff cap in February 2022<sup>13</sup> to allow suppliers to recover the costs associated with procuring energy for unexpected and unhedged default tariff customers, due to a) an unforeseeable increase in the number of customers moving to default tariffs at the end of a fixed-term contract (FTC) expiration, and b) and unforeseeable reduction in the number of customers moving away from default tariffs to FTCs. This allowance explicitly excluded costs relating to SoLR customers.

We acknowledge that for some suppliers costs of a similar nature may have arisen with respect to SoLR customers (although note that the hedging took place much closer to delivery compared to non-SoLR customers), and that these costs may have exceeded the allowances included in the cap.

We note that a significant amount of the wholesale element of Shell's claim is related to the costs of hedges for which sufficient evidence has not been received. In order to determine whether these costs are in line with the SoLR principles, we require evidence as set out to Shell in our correspondence with them. We consider that in this case the evidence received has not given us sufficient confidence that the approach taken, and therefore the level of

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<sup>13</sup> <https://www.ofgem.gov.uk/publications/price-cap-decision-potential-impact-increased-wholesale-volatility-default-tariff-cap>

these costs, is in line with all SoLR principles. In particular, whether the costs are consistent with our economic principle, namely whether the SoLR made all reasonable efforts to avoid the cost in the first instance.

We are minded to disallow this element of Shell's claim resulting in a deduction of £659,485.60 for Colorado. Where Shell consider that they have evidence that demonstrates that they have acted consistent with our economic principle, and are able to submit evidence consistent with the above, they should provide this evidence to us and we will take this into account in our final decision.

We also note that a number of shorter-term gas trades included in the claim appear to have been classified as 'shipper costs' and constitute a significant amount of volume additional to the initial hedge for delivery during Q4 2021. The appropriate treatment of these costs is uncertain based on the information given. However, in principle we may be minded to allow these costs subject to receiving further explanation and evidence that satisfies us as to the validity of these trades and how they meet our previously stated principles, including justification for the correct comparator being used for revenue recovered from customers. In this minded-to position we have not yet made any deductions regarding these costs. In order to provide sufficient time for us to fully consider and assess any further evidence, please provide this further information by 8 November. We are minded to not allow the claim for these costs if we do not receive the additional information or if we are not satisfied that the information provides sufficient evidence that these costs meet our criteria.

We welcome any submissions on these proposed deductions, and the approach we have taken to calculating it, in response to our minded to position by the end of the consultation period.

### **Cost Category: Credit balances**

Our published guidance sets out that we may in certain circumstances consider it appropriate to approve a claim associated with costs incurred in repaying credit balances to customers who had a positive credit balance with a failed supplier.

### Decision

Shell has requested our consent to recover £468,831.06 in credit balances through the LRSP for the cost of refunding credit balances to customers and former customers of Colorado at the time the company ceased trading. Under Supplier SLC 9.4(b) a SoLR may

claim any sums paid or debts assumed to compensate customers of the failed supplier respect of any customer credit balances.

Table 2: Summary of claims for credit balances

<b>Item</b>	<b>Cost</b>	<b>Initial Claim</b>	<b>True-up claim</b>	<b>True-up deductions</b>	<b>Minded-to position on claim</b>
2	Credit balances	£0	£468,831.06	£0	£468,831.06

Rationale for decision:

Shell has requested our consent to recover £468,831.06 through the LRSP for the cost of refunding credit balances to customers and former customers of Colorado at the time the company ceased trading. Under Supplier SLC 9.4(b) a SoLR may claim any sums paid or debts assumed to compensate customers of the failed supplier respect of any customer credit balances.

At the time that Shell was appointed a SoLR they committed to cover a proportion of the value of credit balances themselves, to reduce a subsequent levy claim. This contribution has been deducted by Shell in their claim and is reflected in our minded-to position.

As part of our assessment of the closed account credit balances, our position is that amounts of credit balance refunds made by cheque should only be recovered by the supplier through the levy once that cheque is cashed. We do not consider that it would be appropriate to allow SoLRs to claim for closed account credit balance cheques until the point that they are actually cashed for the following reasons:

- To avoid consumers bearing the cost of compensation for credit balances never in fact received by customers of the failed supplier.
- To ensure that the SoLR does not profit from a situation where some credit balance cheques are never presented; and
- Noting that a future LRSP claim can be made so that Shell can recover the cost of any credit balance cheques presented after the cut off point for the current claim.

Shell confirmed an assessment of the inclusion of uncashed cheques has been made and none have been included as part of this claim. Therefore, in line with the above we do not need to make a deduction on this basis.

We are satisfied in this case that the claimed amount and corresponding evidence for open account credit balances is consistent with our assessment criteria. Shell have confirmed, as far as possible, that no incentive or reward payments, Warm Home Discount payments or

compensation payments are included in the credit balance costs. Shell also provided an explanation of their sampling to provide assurance that credit balances had been returned to customers and an explanation of the process used in determining the accuracy of customer credit balances. Credit balance costs for former customers of Colorado are additional to the costs to the SoLR of existing customers and directly incurred as a result of acting as a SoLR in an emergency situation. Given this, and in the circumstances of this particular case, we are minded to approve this portion of the claim.

### **Cost Category: Working Capital**

In the period between its appointment as SoLR and recovering funds through the industry levy, Shell may have incurred costs in making capital available to fund costs associated with the SoLR process. Suppliers must 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.

While a SoLR may seek to claim for financing costs via a LRSP and within the legal framework within which we operate, we are mindful of the pressures that consumers have been facing with the rising cost of energy. Given that the costs SoLRs claim for via a LRSP are ultimately borne by consumers, we would expect SoLRs also to be very mindful of these pressures and take this into account when determining the costs that the SoLR decides to claim through the SoLR levy. In particular, in circumstances where financing costs arise from parent/intra-group arrangements, we would expect the Company Group to consider very carefully whether it is appropriate for their Supply business to be claiming working capital costs at all and, if so, what rate is reasonable, when many consumers are struggling to be able to pay their energy bills.

### Decision:

Shell's claim includes £709,758.49 for the cost of working capital. The calculation includes costs incurred over the course of 27 months to reflect actual costs incurred and the timescale for the recovery of those costs as set out in our published decision on the last resort levy claims true-up process<sup>14</sup>.

Based on the evidence provided and our assessment we consider that the rate used and the methodology used to calculate the claimed amount is consistent with our assessment criteria and we are minded to consent to the claim pending Shell making the necessary

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<sup>14</sup><https://www.ofgem.gov.uk/sites/default/files/2022-09/Decision%20on%20the%20last%20resort%20levy%20claims%20true-up%20process.pdf>

changes to its working capital calculations to reflect any costs we have disallowed from the overall claim.

Table 3: Summary of claims for working capital

<b>Item</b>	<b>Cost</b>	<b>Initial Claim</b>	<b>True-up claim</b>	<b>True-up deductions</b>	<b>Minded-to position on claim</b>
4	Working capital	£0	£709,758.49	£0	£709,758.49

Rationale for decision:

When a SoLR is appointed, it incurs costs associated with taking on the new customers which need to be financed. There are a range of ways in which a SoLR can finance this activity. Regardless of the finance option used, there is a cost in doing so. Suppliers may seek to claim through the levy to recover the financing costs that they have faced in acting as a SoLR.

Shell has submitted a claim for the cost of working capital amounting to £709,707.70. We believe that Shell's proposed rate is reasonable when compared against the range of rates secured for initial claims and the overall market movements since the submission of initial claims.

Shell submitted evidence that detailed its expenditure relevant to its claim for working capital costs, as well as justification for why it had applied the relevant interest rate. We consider that the working capital costs being claimed for have been directly incurred as a result of acting as the SoLR in an emergency situation and represent costs that are additional to the costs to the SoLR of its existing customers.

We believe that Shell's proposed rate is reasonable when compared against the range of rates secured for initial claims and the overall market movements since the submission of initial claims.

As set out above, we consider that the rate at which working capital has been calculated, and the methodology followed, is consistent with our criteria and reasonable in these cases and for these purposes only. However, working capital may only be claimed on costs that meet our criteria for assessing claims. In light of our minded-to position to make deductions to other cost categories and/or to make deductions where further evidence is not forthcoming, we are unable to undertake the calculations on working capital to arrive at



what allowed amount on working capital should be. As such, the total amount of working capital claimed for of £709,758.49 is subject to Shell resubmitting a revised working capital claim taking into account the deductions in our minded to position. In order to fully assess the working capital aspect of the claim, we therefore require Shell to recalculate the working capital element of their claim for Colorado using, as costs incurred, the amounts we state in this document we are minded-to consent to.

When recalculating the working capital element of their claim, we expect Shell to follow the same methodology, and apply the same rate, as their 7th October submission, and to clearly set out which costs have been reduced or removed. We also ask that Shell submit their full calculations to allow us to undertake these calculations on working capital unilaterally for our final decision, so that we can work out what their working capital allowance should be, without having to revert to Shell. As we have already assessed the methodology used to calculate the working capital element of the claim, we will not require the resubmitted calculations to be subject to an audit.

### **Cost Category: “Other costs”**

We understand that other costs may have been incurred when undertaking activities as part of becoming a SoLR (for example, operational costs). We have used the criteria set out in our published decision on the last resort levy claims true-up process<sup>17</sup> to assess whether these costs are appropriate and should be recovered through a LRSP. The other costs that Shell has claimed are detailed below alongside our minded-to position.

#### Decision

Shell’s claim includes £77,826.84 in other costs, which included legal costs, IT licence costs, Renewable Energy Guarantees of Origin (REGO) Costs and other costs related to taking on Colorado’s customers.

With the exception of REGO costs, which we have deducted, we consider the costs are reasonable and in line with our assessment criteria subject in some cases to the assessment of further evidence to be provided by Shell. Therefore, we are minded to consent to a claim of £8,918.91

At the time that Shell was appointed a SoLR they committed to cover a proportion of the value of their migration costs, this includes all “other costs” but does not include REGO costs. This has been deducted by Shell in their claim for the total of their migration costs.

We have replicated the deduction of this commitment across all of their individual claims under the “other costs” category other than REGO costs. This is reflected in our minded-to position.

Table 4: Summary of claims for “other costs”

<b>Item</b>	<b>Cost</b>	<b>Initial Claim</b>	<b>True-up claim</b>	<b>True-up deduction</b>	<b>Minded-to position on claim</b>
3	Other costs	£0.00	£77,826.84	£68,907.93	£8,918.91

Rationale for decision:

*Legal costs*

Shell’s claim includes legal costs. While evidence has been provided to demonstrate that these costs have been incurred, we are not fully satisfied that the evidence provided to support this portion of the claim meets our criteria that the costs incurred must be additional and economic. However, we agree in principle that extra legal costs for customers acquired through the SoLR process may be additional and a direct result of acting as a SoLR in an emergency situation. We are therefore, in principle, minded-to allow this portion of the claim but only provided that Shell provides further evidence, before the end of the consultation period, that these costs were over and above costs Shell would have incurred if these customers were acquired outside of the SoLR process, and through normal customer acquisition routes, and that efforts had been made to minimise these costs.

Shell included a total other legal cost that could not be attributed to an individual supplier across all of their claims. We are minded to allow this total cost on the basis that we agree in principle that these costs meet our criteria. However this is conditional on Shell being able to provide further detail on how this cost is attributed to each claim<sup>15</sup>.

*Finance Contracting Costs*

Shell’s claim includes finance contracting costs. While evidence has been provided to demonstrate that these costs have been incurred, we are not fully satisfied that the evidence provided to support this portion of the claim meets our criteria that the costs

<sup>15</sup> For the avoidance of doubt, the claim for these legal costs has not been included in our minded-to position. This will be considered once further evidence is received.

incurred must be additional and economic. However, we agree in principle that extra resourcing costs for customers acquired through the SoLR process may be additional and a direct result of acting as a SoLR in an emergency situation. We are therefore, in principle, minded-to allow this portion of the claim but only provided that Shell provides further evidence, before the end of the consultation period, that these costs were over and above costs Shell would have incurred if these customers were acquired outside of the SoLR process, and through normal customer acquisition routes, and that efforts had been made to minimise these costs.

#### *Customer service costs*

Shell's claim also includes costs incurred as result of contracting with a third-party to send communications to SoLR customers to keep them informed about their transition.

We have assessed the evidence provided, including detailed invoices of direct costs incurred through SoLR activity and narrative explanations of the reasons for choosing the third-party, and are satisfied that the costs incurred meet our criteria and invoices. In particular, we are satisfied that these costs are otherwise unrecoverable and we are satisfied with the processes put in place to minimise the costs to consumers. The costs incurred in dealing with these operational issues are a direct result of Shell's appointment as SoLR and are additional to those that it would have faced in the course of its normal retail operations. We consider that the claimed amount is consistent with our criteria and we are minded to consent to the customer agent portion of the claim.

#### *IT Licence costs*

Shell's claim includes IT licence costs for software used throughout the SoLR process. While evidence has been provided to demonstrate that these costs have been incurred, we have been unable to currently assess the evidence provided to confirm this portion of the claim meets our criteria that the costs incurred must be additional and economic. However, we agree in principle that the licence costs for software used through the SoLR process may be additional and a direct result of acting as a SoLR in an emergency situation. We are therefore, in principle, minded-to provisionally allow this portion of the claim subject to further assessment of the evidence provided.

#### *Debt Collection Agency costs*

Shell claim includes costs incurred as result of contracting with a third-party for debt collection agency.

We have assessed the evidence provided, including detailed invoices of direct costs incurred through SoLR activity and narrative explanations of the reasons for choosing the third-party, and are satisfied that the costs incurred meet our criteria. In particular, we are satisfied that these costs are otherwise unrecoverable and with the processes put in place to minimise the costs to consumers. The costs incurred in dealing with these issues are a direct result of Shell's appointment as SoLR and are additional to those that it would have faced in the course of its normal retail operations. We consider that the cost incurred is also reasonable within the circumstances of this case. As a result, we consider that the claimed amount is consistent with our criteria and we are minded to consent to the debt collection agency costs portion of the claim.

#### *Renewable Energy Guarantees of Origin (REGO) Costs*

Shell have claimed for £68,907.93 for Renewable Energy Guarantees of Origin (REGO) costs as part of their claim for the true-up of the SoLR levy claim for the new SoLR customers they have taken on.

They argue that in order to maintain the Shell and Colorado's customer proposition of renewable power for all customers, so as not to discriminate against and misrepresent its product offering to SoLR customers, additional REGO's for SoLR customers will be required. While we understand that Shell wants to maintain its renewable credentials, this is a business decision for Shell and not a mandatory obligation. We are therefore minded to disallow this part of the claim.

#### **SoLR Internal Audit outcome**

In compliance with our published policy on the true-up process Shell undertook an independent internal audit to assess the accuracy of the true-up claims.

We are content that the audit and the declaration, which was signed by the Finance Director, provides sufficient assurance of the accuracy of the information provided to us to support Shell's claim.

#### **Next steps**

The purpose of this letter is to provide interested parties with an opportunity to make

any representations to us, ahead of us making our final decision on this LRSP claim. We invite any representations by 30 November 2022. Responses should be emailed<sup>16</sup> to [solrlevyteam@ofgem.gov.uk](mailto:solrlevyteam@ofgem.gov.uk).

We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so that they can be placed easily on our website.

We will take into account all relevant information, including any representations we receive and the results of our external audit of our assessment process, in reaching our final decision on Shell's claim. We expect to make our final decision in mid-December 2022.

Yours faithfully,

**Neil Lawrence**  
**Director, Retail Directorate**

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<sup>16</sup> Although we prefer responses in electronic format, responses can be posted to the address below.