

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

Email: solrlevyteam@ofgem.gov.uk

4 November 2022

Dear Colleague,

Last Resort Supply Payment Claim from Octopus

On 10 October 2022, Octopus¹ gave notice to Ofgem of its intention to submit a claim for a Last Resort Supply Payment ("LRSP") in line with the "True Up" process and methodology, explained further below. Octopus is seeking to recover additional, otherwise unrecoverable costs incurred in acting as Supplier of Last Resort (SoLR) to customers of the former Avro.

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 Octopus 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 Octopus claiming a LRSP of up to £36,347,556.38. This total is subject to recalculation of the working capital figure by Octopus. 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 Octopus to resubmit their working capital calculation no later than the end of the day on **Tuesday 8 November 2022**.

We are minded to allow Octopus to claim for costs incurred in complying with a Last Resort Supply Direction)² relating to

- Additional wholesale costs incurred as a result of commitments to supply energy to SoLR customers;
- protecting the credit balances owed to former customers of Avro;

1 Company Number 09263424

2 <https://www.ofgem.gov.uk/publications/ofgem-appoints-octopus-energy-take-customers-avro-energy>

- financing costs incurred on becoming a SoLR; subject to recalculation of the financing costs element of the claim by Octopus; and
- 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 Octopus 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 Octopus 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 notice³.

Avro Supplier event

On 26 September 2021, we appointed Octopus as the SoLR for Avro⁴ gas⁵ and electricity⁶ customers, following its announcement that it had ceased trading. This followed an appointment process aimed at getting the best deal for consumers. We outlined the material factors behind our decision to appoint Octopus as the SoLR to those customers in our decision letter published on 23 June 2022⁷.

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.

³ 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).

⁴ [Ofgem appoints Octopus Energy to take on customers of Avro Energy | Ofgem](#)

⁵ [Direction to appoint Octopus Energy Limited as Gas Supplier of Last Resort for customers of Avro Energy Limited | Ofgem](#)

⁶ [Direction to appoint Octopus Energy Limited as Electricity Supplier of Last Resort for customers of Avro Energy Limited | Ofgem](#)

⁷ [Appointment of Octopus Energy Limited as Supplier of Last Resort \(ofgem.gov.uk\)](#)

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 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 end of March 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 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.

Our process to reach our minded-to position included:

- a. A quantitative check of Octopus methodology for each cost item claimed. This included determining how each total cost item was calculated based on data sent to us by Octopus and ensuring these costs were in line with commitments Octopus 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.

Octopus' Claim

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

The initial claim(s) were 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 Octopus was given a Last Resort Supply Direction and in accordance with the True-up Agreement in relation to customers of the former Avro, Ofgem is minded to consent to Octopus claiming a LRSP of up to £36,347,556.38. This total is subject to recalculation of the working capital figure by Octopus.

Under the supplier SLCs we are required to consider on a case-by-case basis whether in the particular circumstances, 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.

Item	Cost	Initial Claim	True-up claim	True-up deductions	Minded-to position on claim
1	Wholesale	£626,836,379.44	£17,828,672.64	£28,308,038.06	-£10,479,365.42
2	Credit balances	£ 37,461,324.35	£13,093,149.42	£42,069.00	£13,051,080.42
4	Working capital	£26,036,959.00	£21,178,747.12	-	£21,178,747.12
3	Other costs	£2,560,654.00	£21,623,822.54	£9,026,728.28	£12,597,094.26
	Total	£692,895,316.79	£73,724,391.72	£37,376,835.34	£36,347,556.38

Reasons for our minded-to decision

Cost Category: Wholesale

General

In our published decision on the claims true-up process⁸ 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 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

⁸ [Decision on last resort levy claims true-up process | Ofgem](#)

The Avro true-up claim includes £17,828,672.64 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 £10,519,132.77 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 2022⁹ ("February 2022 Decision") and our decision on possible wholesale cost adjustment in August 2022¹⁰ ("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.
- A deduction of £9,666,455.11 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 £8,122,450.18 for the revenue received from SoLR customers in respect of the retrospective Shaping & Imbalance element of the Wholesale Risk Allowance in the price cap (as set out in our February 2022 Decision), which will be collected from customers between April 2022 and March 2023. The deduction has been calculated based on a value of £12 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.

The proposed total deduction is £28,308,038.06 leading to a net wholesale true-up claim of -£10,479,365.42. When taking into account the initial claims made in December 2021, the total wholesale costs approved would be £616,357,014.02.

Item	Cost	Initial Claim	True-up claim	True-up deduction categories	True-up deduction amounts	Minded-to position on claim
1	Wholesale	£626,836,379.44	£17,828,672.64	Backwardation	£10,519,132.77	
				Contracts for Difference	£9,666,455.11	
				Retrospective shaping allowance	£8,122,450.18	
						-£10,479,365.42

⁹ [Price Cap - Decision on the potential impact of increased wholesale volatility on the default tariff cap | Ofgem](#)

¹⁰ [Price Cap - Decision on possible wholesale cost adjustment | Ofgem](#)

Note: we are unable to calculate the proportion of the wholesale claim made up of backwardation, CfD and retrospective shaping and imbalance. 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-SoLR¹¹. 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 which have proved to be highly uncertain and prone to error in this unprecedented time for the market (as seen by previous 'unexpected SVT demand' allowances). 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 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 forecast¹².

¹¹ This is in contrast to the allowance for Unexpected SVT Demand, which did exclude costs related to SoLR customers

¹² <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>

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 decision¹³ 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

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.

Shaping Allowance:

We note that elements of shaping were included in the claim by Octopus. Ofgem clearly stated in our decision in September 2022¹⁴ that, 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.

Based on our checks of the data submitted, and a comparison with the alternative approach of relying only on the shaping allowances in the cap rather than actual short-term shaping trades, we believe the approach taken by Octopus shows that the shaping costs incurred for the SoLR customers are below those allowed for in the shaping allowance. As this does not represent 'further incremental shaping and imbalance costs' above the allowances, and it aligns with our 'economic' principle outlined for levy claim assessments that the SoLR should make reasonable efforts to avoid or absorb SoLR costs, Ofgem is minded to accept this aspect of the claim and welcome Octopus's adherence to the principle to keep the costs of this process as low as possible for customers. We do not expect Octopus to submit a revised claim, as they have already demonstrated to us that they have made reasonable efforts to avoid the shaping allowance cost.

As shaping costs were included in this claim, the price cap shaping allowance was rightly accounted for and removed in calculations by Octopus. However we also note that in February 2022¹⁵ Ofgem introduced a retrospective allowance into the default tariff cap to allow suppliers to recover additional revenue in relation to electricity shaping and imbalance costs, which had been materially higher in winter 2021/22 than the price cap had accounted for. An amount of £12 per electricity 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.

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

¹⁴ <https://www.ofgem.gov.uk/publications/decision-last-resort-levy-claims-true-process>

¹⁵ <https://www.ofgem.gov.uk/publications/price-cap-decision-potential-impact-increased-wholesale-volatility-default-tariff-cap>

This allowance will be recovered from all customers, SoLR and non-SoLR. Given this, we consider that the revenues collected under this allowance should be offset against any claims made by SoLRs in relation to the costs of shaping and imbalance which we are otherwise minded to allow, given the principles set out above on when we will and will not accept claims for shaping costs, namely only when the supplier has demonstrated that they have been able to shape below the price cap shaping allowance.

To calculate the appropriate amount to deduct, we have, as with the backwardation allowance (and for similar reasons), used our best estimate of the remaining SoLR customer accounts as of the end of winter 2021/22, combined with an estimate of annualised demand for these customers, whilst adjusting the price to account for line losses.

Re-hedging and unexpected demand:

The claim includes costs incurred in relation to re-hedging which took place in the period immediately after being appointed as the SoLR, and we note that we understand these re-hedging activities to be related to the evolution of forecasts around customer churn and demand through winter 2021/22.

For non-SoLR customers, a retrospective allowance was introduced into the default tariff cap in February 2022¹⁶ 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 are satisfied that Octopus has provided sufficient evidence of how and why their demand forecasts evolved over time, and demonstrated a reasonable approach to managing this risk, and therefore have allowed them to claim costs for re-hedging.

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.

¹⁶ <https://www.ofgem.gov.uk/publications/price-cap-decision-potential-impact-increased-wholesale-volatility-default-tariff-cap>

Decision

Octopus' claim includes £13,093,149.42 in credit balances through the LRSP for the cost of refunding credit balances to customers and former customers of Avro 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.

We consider that the claimed amount for honouring the credit balances of accounts where cheques have been cashed is consistent with our criteria and we are minded to consent to this portion of the claim.

Table 2: Summary of claims for credit balances

Item	Cost	Initial Claim	True-up claim	True-up deductions	Minded-to position on claim
2	Credit balances	£37,461,324.35	£13,093,149.42	£42,069.00	£13,051,080.42

Rationale for Decision

Octopus has requested our consent to recover £13,093, 149.42 through the LRSP for the cost of refunding credit balances to customers and former customers of Avro 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.

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 Octopus can recover the cost of any credit balance cheques presented after the cut off point for the current claim.

Octopus provided a breakdown of cashed and uncashed cheques specifically for its SoLR customers. The total value of these cheques at the point of submission was £42,069.00. As a result and based on our position on uncashed cheques outlined above, we are minded to disallow this portion of the claim.

Otherwise, we are satisfied in this case that the claimed amount and corresponding evidence for calculating credit balances is consistent with our assessment criteria outlined above. Octopus has provided an explanation of its process of determining customer credit

balances with the administrator. Octopus confirmed that through its engagement with the administrator it was not aware of credit balances being made up of anything other than customer payments, that no incentive or reward payments or compensation payments are included in the credit balance costs and that Avro was not a warm home discounts provider.

We have considered whether the costs Octopus is seeking to claim for credit balances are otherwise unrecoverable; it may still be the case that Octopus is able to recover some of this claimed amount through the ongoing administration process for Avro, to which Octopus has, in accordance with the requirements of the LRSP process, submitted a subrogated creditor claim for the costs incurred in repaying credit balances. We propose to make our final decision on Octopus's claim ahead of the conclusion of the liquidation process, the timescale of which is uncertain. Given this, we are minded to approve this element of the claim, subject to the outcome of the Avro liquidation process.

At this point, the final amount Octopus can claim would be adjusted to include costs recovered through the liquidation process.

We are therefore minded to allow this portion of Octopus' claim minus the deductions for uncashed cheques.

Cost Category: Working Capital

In the period between its appointment as SoLR and recovering funds through the industry levy, Octopus 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 decide 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:

Octopus' claim includes £21,178,747.12 for the cost of working capital. The calculation includes actual costs incurred and the timescale for the recovery of those costs.

Based on the evidence provided and our assessment we are not satisfied in this case that the claimed amount and corresponding evidence with regards to the interest rate applied to calculate working capital are consistent with our assessment criteria. We are minded-to allow the total claim for working capital costs, subject to further evidence being submitted by Octopus that may provide further detail on the reasoning behind their rate submitted on

7 of October or an updated rate based on further discussions with us through the consultation period.

Table 3: Summary of claims for working capital

Item	Cost	Initial Claim	True-up claim	True-up deductions	Minded-to position on claim
3	Working capital	£26,036,959.00	£21,178,747.12	£0	£21,178,747.12

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.

Octopus submitted a claim for the cost of working capital amounting to £21,178,747.12. It submitted evidence that detailed its expenditure relevant to its claim for working capital costs. However, we believe that Octopus’ proposed rate is unreasonable when compared against the range of rates secured for initial claims and the overall market movements since the submission of initial claims. Our decision as to a reasonable rate of interest on working capital in this case has been taken considering our criteria for these SoLR levy claims and what we consider to be reasonable and appropriate in all these circumstances and for these purposes only.

As set out above, we consider that notwithstanding our concerns about the rate at which working capital has been calculated; 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 Octopus’s claim for internal resourcing, we are unable to undertake the calculations on working capital to be able to make a decision on the amount to be allowed for working capital. As such, the total amount of working capital claimed for of £21,178,747.12 is subject to Octopus resubmitting a revised working capital claim taking into account the deductions in this minded to position. As explained above, in order to fully assess the working capital aspect of the claim, we therefore require Octopus to recalculate the working capital element of their claim for Avro 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 Octopus to follow the same methodology as their previous submission and apply the rate provided to Octopus and clearly set out which costs have been reduced or removed. We also ask that Octopus submit their full calculations in sufficient detail to allow us to work out what their working capital allowance should be, without having to revert to Octopus.

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 to assess whether these costs are appropriate and should be recovered through a LRSP. The other costs that Octopus has claimed are detailed below alongside our minded-to position.

Decision

Octopus' claim includes a total of £21,623,822.54 in other costs. We do not consider that the £9,026,728.28 claimed for Administrator-withheld funds costs is consistent with our criteria. Subject to being provided with additional evidence we are minded, in principle, to consent to claims for the other categories of costs. Provided that we are given further evidence, we are minded to consent to a claim of £12,597,094.26, following the deduction of £9,026,728.28 for Administrator-withheld funds costs.

Table 4: Summary of claims for "other costs"

Item	Cost	Initial Claim	True-up claim	True-up deductions	Minded-to position on claim
4	Other costs: administrator, IT costs, programme fees, administrator-withheld funds, project management costs, indemnity claims.	£2,560,654.00	£21,623,822.54	£9,026,728.28	£12,597,094.26

Rationale for Decision

Administrator Costs

Octopus claim includes £1,639,101.36 for administrator costs incurred in onboarding former customers of Avro. We have assessed the evidence provided, including invoices and narrative explanations provided by Octopus and detail verified within audit documentation, and are satisfied that the costs incurred meet our criteria. In particular, we have determined that the costs incurred in dealing with these administrator costs are related to Octopus's SoLR role, are additional to those that it would have faced in the course of its normal retail operations and are not recoverable in any other way.

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 administrator costs portion of the claim.

IT costs

Octopus claim includes £6,751,162.15 for IT costs in taking on former customers of Avro. We have assessed the evidence provided, including invoices and narrative explanations provided by Octopus and detail verified within audit documentation, and are satisfied that the costs incurred meet our criteria. In particular, we have determined that the costs incurred in dealing with these IT costs are directly related to Octopus's SoLR role, are additional to those that it would have faced in the course of its normal retail operations and are not recoverable in any other way.

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 IT costs portion of the claim.

Programme Fees

Octopus' claim includes £10,004,766 programme fees. 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 programme fees 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 minded-to allow this portion of the claim but only provided that Octopus provides further evidence, before the end of the consultation period, that these costs were over and above costs Octopus 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.

Administrator-withheld funds

Octopus' claim includes £9,026,728.28 of funds being withheld by the Administrator. There is an ongoing legal case in order for Octopus to recoup these funds. As Octopus may successfully recover these funds through other means, we are minded not approve this element of the claim. However, should Octopus be unsuccessful in their legal action they can re-submit for consideration in a subsequent True-Up process.

Project Management Costs

Octopus claim includes £152,626.00 for project management 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 project management 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. This is on the condition, but only provided that Octopus provides further evidence, before the end of the consultation period, that these costs were over and above costs Octopus 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.

Indemnity Claims

Octopus claim includes £249,760.17 for indemnity claims. 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 and economic. However, we agree in principle that indemnity claims 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 Octopus provides further evidence, before the end of the consultation period, that these costs were over and above costs Octopus 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.

SoLR Internal Audit outcome

In compliance with our published policy on the True-up process Octopus 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 Octopus's claim.

Next steps

The purpose of this letter is to provide the SoLR and 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 emailed²⁵ to 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 internal audit of our assessment process in reaching our final decision on Octopus claim. We expect to make our final decision by mid-December 2022.

Yours faithfully,

Neil Lawrence
Director, Retail Directorate