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Gas and Electricity Suppliers,
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Gas Transporters and all other interested parties

Email: solrlevyteam@ofgem.gov.uk
04 November 2022

Dear Colleague

Last Resort Supply Payment Claim from ScottishPower Energy Retail Limited

On 7 October 2022, ScottishPower Energy Retail Limited ("ScottishPower") 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. ScottishPower is seeking to recover additional, otherwise unrecoverable costs incurred in acting as Supplier of Last Resort (SoLR) to customers of the former Entice Energy Supply Limited ("Entice").

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 Operator. The True-up claim from ScottishPower 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 ScottishPower claiming a LRSP of up to £474,130.38. This total is subject to recalculation of the working capital figure by ScottishPower. 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 ScottishPower to resubmit their working capital calculation no later than the end of the day on **Tuesday 8 November 2022.**

We are minded to allow ScottishPower to claim for costs incurred in complying with a Last Resort Supply Direction[1] 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 Entice; and
- working capital costs incurred on becoming a SoLR, subject to recalculation of the working capital element of the claim by ScottishPower.

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

[1] Direction to appoint ScottishPower Energy Retail Limited as Electricity Supplier of Last Resort and Direction to appoint ScottishPower Energy Retail Limited as Gas Supplier of Last Resort

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 ScottishPower 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 ScottishPower 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, the results of 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[2].

Entice Energy SoLR event

On 30 November 2021, we appointed ScottishPower as the SoLR[3] for Entice gas[4] and electricity[5] 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 ScottishPower as the SoLR to those customers in our decision letter published on 18 March 2022[6].

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.

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[2] 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).

[3] Ofgem appoints Scottish Power to take on customers of Entice Energy and Orbit Energy

[4] Decision to Appoint ScottishPower Energy Retail Limited as Gas Supplier of Last Resort

[5] Direction to Appoint ScottishPower Energy Retail Limited as Electricity Supplier of Last Resort to Simply Your Energy Limited (Simply Your Energy Limited traded as Entice Energy Supply Limited)

[6] Appointment of ScottishPower Energy Retail Ltd as Supplier of Last Resort for Entice Energy Supply Ltd and Simply Your Energy Ltd

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 from November 2021 to May 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[7] 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 ScottishPower's methodology for each cost item claimed. This included determining how each total cost item was calculated based on data sent to us by ScottishPower and ensuring these costs were in line with commitments ScottishPower 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

[7] https://www.ofgem.gov.uk/sites/default/files/2022-09/Decision%20on%20the%20last%20resort%20levy%20claims%20true-up%20process.pdf

d. A qualitative and quantitative assessment of the claim for costs related to credit balances and financing 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.

<u>ScottishPower's claim</u>

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

The initial claim was consented to on 17 December 2021[8]. 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 a claim for LSRP by ScottishPower was consented to, and in accordance with the True-up Agreement in relation to customers of the former Entice, Ofgem is minded to consent to ScottishPower claiming a LRSP of up to £474,130.38. This total is subject to recalculation of the working capital figure by ScottishPower.

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

[8] Faster SoLR levy process: consents to Last Resort Supply Payments

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	£2,377,284.47	£183,419.36	£98,344.44	£85,074.92
2	Credit balances	-	£359,847.56	£28,468.83	£331,378.73
3	Working capital	-	£57,676.73	-	£57,676.73
	Total	£2,377,284.47	£600,943.65	£126,813.27	£474,130.38

Reasons for our minded-to decision

Cost category: Wholesale

In our published decision on the claims True-up process[9] 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

Scottish Power submitted two claims, one covering wholesale energy costs to the end of May 2022, in line with our September policy decision, and other covering wholesale costs to end the September 2022. However, we consider the evidence provided by ScottishPower was not sufficient for us to change our September policy position to allow them to exceptionally claim costs up to the end of September 2022. This minded to position therefore relates to their claim for costs up to the end of May 2022 only. Were additional

[9] Decision on last resort levy claims true-up process | Ofgem

evidence to be provided to justify a claim over a longer period, we would be open to considering it as part of the True-up process.

<u>Decision</u>

The Entice True-up claim includes £183,419.36 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 £56,039.32 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[10] ("February 2022 Decision") and our decision on possible wholesale cost adjustment in August 2022[11] ("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 £42,305.12 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.

The proposed total deduction is £98,344.44 leading to a net wholesale True-up claim of £85,074.92. When taking into account the initial claims made in December 2021, the total wholesale costs approved would be £2,462,359.39.

Table 2: Summary of claims and minded-to position 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	£2,377,284.47	£183,419.36	Backwardation	£56,039.32	[redacted]
				Contracts for Difference	£42,305.12	
						£85,074.92

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

<u>Rationale for decision:</u>

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

[10] Price Cap - Decision on the potential impact of increased wholesale volatility on the default tariff cap | Ofgem
[11] Price Cap - Decision on possible wholesale cost adjustment | Ofgem

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[12]. 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 forecast[13].

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[14] 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

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

[13] 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

[14] https://www.ofgem.gov.uk/publications/price-cap-decision-potential-impact-increased-wholesale-volatility-default-tariff-cap

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.

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:

The ScottishPower claim includes £359,847.56 in credit balances repaid to date to former customers of Entice. We consider that the claimed amount is consistent with our criteria and we are minded to consent to the claim with a deduction of £28,468.83 for uncashed cheques.

Table 3: Summary of claims and minded to position for credit balances

Item	Cost	Initial Claim	True-up claim	True-up deductions	Minded-to position on claim
2	Credit balances	-	£359,847.56	£28,468.83	£331,378.73

Rationale for decision:

ScottishPower has requested our consent to recover £359,847.56 through the levy for the cost of refunding credit balances to customers and former customers of Entice at the time the company ceased trading. We note that ScottishPower committed to honouring the first £700,000.00 of credits for Entice customers in their initial SoLR bid and their credit balance True-up claim is additional to this. 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.

We are satisfied in this case that the claimed amount and corresponding evidence for open account credit balances is consistent with our assessment criteria. ScottishPower 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. ScottishPower 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. We consider that the claim is consistent with ScottishPower's commitment at the time of its appointment as SoLR for customers of Entice. Given this, and in the circumstances of this particular case, we are minded to approve this portion of the claim.

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

ScottishPower provided a breakdown of cashed and uncashed cheques specifically for its SoLR customers and stated it would reduce its claim to reflect any uncashed element. The total value of uncashed cheques at the point of submission was £28,468.83. As a result, and consistent with ScottishPower's position, we are minded to disallow this portion of the claim.

We have considered whether the costs ScottishPower is seeking to claim for credit balances are otherwise unrecoverable; it may still be the case that ScottishPower is able to recover some of this claimed amount through the ongoing administration process for Entice, to which ScottishPower 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 of ScottishPower's claim ahead of the conclusion of the liquidation process, the timescale of which is uncertain. Given this, we are minded to approve to open account credit balances element of the claim, subject to the outcome of the Entice liquidation process.

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

Cost category: Working capital

In the period between its appointment as SoLR and recovering funds through the industry levy, ScottishPower may have incurred costs in making capital available to fund costs associated with the SoLR process. Suppliers must demonstrate, with evidence, that their financing costs claim delivers value for money for consumers and is the best possible rate they could achieve given their individual circumstances.

Decision:

ScottishPower's claim includes £57,676.73 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[15].

We consider that the claim is consistent with our criteria, however the total amount is subject to ScottishPower resubmitting a revised working capital claim taking into account the deductions in our minded to position.

Table 4: Summary of claims for working capital

Item	Cost	Initial Claim	True-up claim	True-up deductions	Minded-to position on claim
3	Working capital	-	£57,676.73	-	£57,676.73

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 uses, there is a cost in doing so. Under Supplier SLC 9.4(a) a SoLR may claim total costs (including interest on working capital) reasonably incurred in supplying premises under the Last Resort Supply Direction.

While a SoLR may seek to claim for financing costs via a LRSP, and within the legal framework in which we operate, we may be in a position to consent to such costs, 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 SoLR to also be very mindful of these pressures and take this into account when determining the costs that the SoLR should be able to recoup from consumers through the SoLR levy. In particular, in circumstances where financing costs arise from parent/inter-company 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 a rate that is funded by consumers, when many consumers are struggling to be able to pay their energy bills. We note that ScottishPower appears to have set a lower working capital rate than market rates and comparative to other intra-group rates, so we do appreciate the attempts to lower the cost to consumers.

Noting the above, and within the legal framework in which we operate, ScottishPower has requested our consent to claim £57,676.73 through the levy for working capital costs accrued for taking on SoLR customers since Entice ceased trading. ScottishPower utilitsed capital from their parent company to secure short term working capital for Entice. ScottishPower clearly demonstrated how the working capital costs were calculated across the 27-month period including providing the dates and values of each transaction, the

[15] https://www.ofgem.gov.uk/sites/default/files/2022-09/Decision%20on%20the%20last%20resort%20levy%20claims%20true-up%20process.pdf

application of a reasonable interest rate for each transaction, and that this rate was the best possible rate they could achieve given their individual circumstances.

Ofgem's assessment of ScottishPower's claim found that an incorrect interest rate for credit balance cost of capital was used for several months' data. This error has resulted in a lower claim than the evidence provided suggests and the original submission was £2,146.82 less than actual cost. As this is evident as a calculation error, we are minded to allow the additional cost to be added to the total value ScottishPower is claiming.

We are satisfied that ScottishPower is unlikely to have secured a better interest rate on the open market than the rate they secured internally. We believe that ScottishPower'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.
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 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 £57,676.73 is subject to ScottishPower 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 ScottishPower to recalculate the working capital element of their claim for Entice 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 ScottishPower to follow the same methodology, and apply the same rate, as their 7 October submission, and to clearly set out which costs have been reduced or removed. We also ask that ScottishPower 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 ScottishPower. 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.

SoLR Internal Audit outcome

In compliance with our published policy on the True-up process[16] ScottishPower undertook an independent internal audit to assess the accuracy of the True-up claims.

We are content that the audit and the declaration signed by the Chief Executive Officer and Financial Director provides sufficient assurance of the accuracy of the information provided to us to support ScottishPower's claim.

[16] https://www.ofgem.gov.uk/sites/default/files/2022-09/Decision%20on%20the%20last%20resort%20levy%20claims%20true-up%20process.pdf

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 emailed[17] 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 ScottishPower's claim. We expect to make our final decision in mid-December 2022.

Yours faithfully,

Neil Lawrence
Director, Retail Directorate

[17] Although we prefer responses in electronic format, responses can be posted to the address below.