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20 December 2022

Dear Colleague

### **Last Resort Supply Payment Claim from British Gas**

On 7 October 2022, British Gas Trading Limited ("British Gas") submitted a claim for a Last Resort Supply Payment (LRSP) for Ofgem's consent under Supply Licence Standard Licence Condition (SLC) 9. British Gas is seeking to recover additional costs incurred in complying with a Last Resort Supply Direction<sup>1</sup> to act as Supplier of Last Resort (SoLR) to customers of the former Simplicity Energy Limited ("Simplicity").

On 4 November 2022 Ofgem published a minded to position in relation to that claim for consultation.<sup>2</sup> Responses to this consultation and consultations on other SoLR claims can be found within this document.

In addition, we conducted internal assurance of our minded to position.

### **Decision to consent**

After taking into consideration the consultation responses and the results of our internal assurance process, on 20 December 2022 Ofgem consented to British Gas making a LRSP claim of up to **£3,024,176.70**.

This letter is the notice of reasons for Ofgem's decision to consent to British Gas making a LRSP claim from relevant network operators. Our decision will allow British Gas to claim for costs relating to:

- protecting the credit balances owed to former customers of Simplicity.

We have assessed this LRSP claim in accordance with our policy decision on the true-up process<sup>3</sup>, published 21 September 2022<sup>4</sup>, and consistent with our published *Guidance*

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<sup>1</sup> [Direction to appoint British Gas Trading Limited as Electricity Supplier of Last Resort | Ofgem](#) and [Direction to appoint British Gas Trading Limited as Gas Supplier of Last Resort | Ofgem](#)

<sup>2</sup> <https://www.ofgem.gov.uk/sites/default/files/2022-11/British%20Gas%20-%20SoLR%20Levy%20claim%20minded-to%20position%20-%20Simplicity.pdf>

<sup>3</sup> While this claim is not part of the multi-claim process, we have considered our latest policy positions on cost areas where they have been relevant for this claim. For example, where we have specified the level of evidence that would be sufficient to assess a claim.

<sup>4</sup> <https://www.ofgem.gov.uk/publications/decision-last-resort-levy-claims-true-process>

*on supplier of last resort and energy supply company administration orders.*<sup>5</sup> In addition, in making this decision, we have had regard to Ofgem's principal objective of protecting the interests of current and future energy consumers<sup>6</sup>, the public sector equality duty<sup>7</sup> relevant licence provisions, and the particular circumstances of the case.

Nothing in this decision should 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.

An overview of British Gas' LRSP claim together with the reasons for decision with respect to this claim are set out below.

## **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. The failure of a supplier may affect a range of groups including its consumers, the wider market and other consumers. Ofgem has discretionary powers that enable it to address these consequences.

It is Ofgem's statutory duty to protect customers' interests when suppliers fail including their interests in the security of energy supply to them<sup>8</sup>. Under Supplier SLC 8 Ofgem can issue a Last Resort Supply Direction to direct any gas or electricity supplier to take over responsibility for a failed supplier's customers.

Generally suppliers are open to taking on the role of SoLR because they acquire a large number of new customers who may remain with them over the longer-term and allow the supplier to increase its margins. As a result, suppliers may compete to be appointed.

In considering which supplier to appoint as SoLR, Ofgem must be satisfied that the SoLR can supply additional customers while continuing to supply its existing customers and to fulfil its contractual obligations for the supply of gas or electricity<sup>9</sup>.

Ofgem's criteria for the selection of a SoLR are set out in its "Guidance on supplier of last resort and energy supply company administration orders"<sup>10</sup> and our stated policy preference is to appoint a SoLR that has volunteered for the role. To understand the terms on which suppliers are willing to volunteer as SoLR, Ofgem requires potential SoLRs to provide information about a number of issues, including customer service, how the supplier would meet SoLR obligations, whether it would make any LRSP claim and, if so, for what categories of costs and with what upper limit. This is done by way of a Request for Information (RFI).

Once a Last Resort Supply Direction has been issued, the responses to the RFI become supplier commitments, which under Supplier SLC 8.3 the SoLR must take all reasonable

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<sup>5</sup> [https://www.ofgem.gov.uk/system/files/docs/2016/10/solr\\_revised\\_guidance\\_final\\_21-10-2016.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/10/solr_revised_guidance_final_21-10-2016.pdf)

<sup>6</sup> s4AA Gas Act 1986 and s3A Electricity Act 1989

<sup>7</sup> Equality Act 2010 Part 11 Sections 149 to 157 [Equality Act 2010 \(legislation.gov.uk\)](http://legislation.gov.uk)

<sup>8</sup> See section 4AA (1A) (b) Gas Act 1986 and section 3A (1A) (b) of the Electricity Act 1989

<sup>9</sup> See Supplier SLC 8(1)(b)

<sup>10</sup> [Supplier of Last Resort: Revised Guidance 2016 | Ofgem](#)

steps to honour. Under Supplier SLC 8 a supplier must comply with a Last Resort Supply Direction, whether or not it volunteered for the SoLR role.

As part of its regulatory responsibilities Ofgem has discretion under Supplier SLC 9<sup>11</sup> to determine the amount of compensation that a SoLR can recover for additional costs incurred as a result of complying with a Last Resort Supply Direction<sup>12</sup>. Ofgem's subsequent exercise of that discretion can not be limited by any response that a supplier makes to an RFI before a Last Resort Supply Direction is issued. SLC 9 makes clear that in deciding whether or not to approve a SoLR levy claim, Ofgem must consider what it considers to be '*appropriate in all the circumstances of the case*'. In making that decision, Ofgem's principal objective is to protect the interests of existing and future consumers and we are very mindful that all amounts consented under SoLR levy claims are paid for by customers.

It is well understood by suppliers that Ofgem must make complex regulatory choices about the allocation of risks and when a supplier has failed. It must do so having regard to the future operation of the market. In particular, Ofgem must balance the need to ensure that its approach to claims for a LRSP ensures that suppliers are not disincentivised from volunteering to become SoLRs while not creating a moral hazard by encouraging suppliers to make commitments on the basis that any losses subsequently incurred could be recovered by way of a LRSP. This is a complex balancing assessment carried out by Ofgem as regulator, having regard to its principal objective to protect consumers.

### Failed Supplier event

On 29 January 2021, we appointed British Gas as the SoLR for Simplicity gas<sup>13</sup> and electricity<sup>14</sup> 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 British Gas as the SoLR to those customers in our decision letter published on 3 March 2021<sup>15</sup>.

### Last Resort Supply Payment

Under SLC 9.1, 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 Operator ("network operators").

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

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<sup>11</sup> See in particular Supplier SLC 9.5 and 9.6

<sup>12</sup> A consent given by Ofgem under SLC 9 may be varied, amended or remade and may be made subject to conditions – see Supplier SLC 2.7.

<sup>13</sup> [Direction to appoint British Gas Trading Limited as Gas Supplier of Last Resort | Ofgem](#)

<sup>14</sup> [Direction to appoint British Gas Trading Limited as Electricity Supplier of Last Resort | Ofgem](#)

<sup>15</sup> [Appointment of British Gas Trading Limited as Supplier of Last Resort | Ofgem](#)

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 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.

### Decision-making process

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. In making this decision Ofgem has considered evidence provided by British Gas, its own knowledge of the energy markets, and responses to consultation on the minded-to position on this claim.

In exercising this decision-making function Ofgem has had regard to the interests of current and future consumers of gas and electricity, and has considered the public sector equality duty.

Ofgem published a minded-to position on this claim and invited consultation responses. British Gas was offered the opportunity to meet with us to clarify aspects of the minded-to position during the consultation period. In reaching its decision Ofgem has taken into consideration any additional evidence provided by British Gas during the consultation period and any consultation responses received in relation to the published minded-to position.

In reaching its decision Ofgem carried out:

- a. A quantitative check of British Gas' methodology for each cost item claimed. This included determining how each total cost item was calculated based on data sent to us by British Gas and ensuring these costs were in line with commitments British Gas made at the time of its SoLR appointment;
  - b. Undertaking validation of some assumptions with other data sources, where appropriate;
  - c. Review and assurance of the calculations made in the published minded-to position; and
  - d. A qualitative and quantitative assessment of the claim for costs related to credit balances 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.

#### Overview of British Gas' claim

British Gas indicated at the time of its SoLR appointment process that it would not waive its right to make a claim for a LRSP for credit balance costs but that it would claim for the cost of honouring and refunding credit balances to former customers of Simplicity, minus a contribution towards those costs.

#### **Summary of decision**

Ofgem has consented to British Gas claiming a LRSP of up to **£3,024,176.70**. The reasons for the decision are set out below. This decision 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.

*Table 1: Summary table*

Item	Cost	This claim	Minded-to deductions	Decision on deductions	Amount approved
1	Credit balances	£3,051,383.74	£27,207.04	£27,207.04	£3,024,176.70
	<b>Total:</b>	£3,051,383.74	£27,207.04	£27,207.04	<b>£3,024,176.70</b>

#### **General points raised in consultation**

##### Summary

We received eight responses to our minded-to positions, with seven responses from SoLRs and one from a consumer group. As this claim is not part of the temporary multi-claim process, not all responses were relevant for this particular claim. We received wide-ranging support and recognition for working efficiently throughout the assessment period to ensure each LRSP claim was given due consideration whilst maintaining engagement with stakeholders. We have expanded below upon each general issue raised in consultation responses to the minded to position that may be relevant for this claim.

### Changes in approach during consultation

Several suppliers claimed in their consultation responses that we had changed our approach during the process, including one supplier who believed that Ofgem had disallowed sums previously agreed in principle. Ofgem made it clear throughout the entirety of the claims process that we would assess each claim on a case-by-case basis, considering the evidence and circumstances of each case before making a decision. Ofgem could not have made a decision on claims before considering all the information provided by SoLRs and any responses to our consultation on our minded-to positions. This was clear from our minded-to positions, which explained that the purpose of the consultation letter was to provide interested parties with an opportunity to make any representations to us, ahead of us making our final decision and that we would take such representations into account when reaching our final decision, making changes to our minded to position if considered appropriate. We also made it clear that our decision might reflect changes resulting from an additional assurance process.

This applies to all LRSP claims made by SoLRs. Ofgem has exercised its statutory discretion to ensure all decisions are fair and reasonable, taking into account the statutory framework, the relevant licence conditions, all the relevant circumstances and no irrelevant factors. The reasons for our decisions with respect to this claim are set out in subsequent sections of this letter. This should not be taken as setting a precedent for any future claims, which would also be considered on their merits and on a case-by-case basis, taking into account all the relevant circumstances of the particular case.

### Volunteering to be SoLR in the future

Several suppliers noted that, due to our positions on certain elements of their claims, they may be less willing to volunteer as SoLR in the future. We note suppliers' concerns. However, Ofgem must make complex regulatory choices about the allocation of risks and costs in the event that a supplier has failed and must do so having regard to the future operation of the market.<sup>16</sup>

In particular, Ofgem must balance the need to ensure that its approach to claims for a LRSP ensures that suppliers are not disincentivised from responding to the SoLR RFI to become SoLRs, whilst not creating a moral hazard, namely, circumstances where suppliers do not respond appropriately or take excessive risks when responding, knowing that any losses subsequently incurred could be recovered by way of a LRSP. This is a complex balancing assessment carried out by Ofgem as regulator, having regard to its principal objective to protect consumers.<sup>17</sup>

We are confident that the process we have undertaken for assessment of these claims has been appropriate, in particular to protect consumers during the current cost of living crisis. In exercising its statutory discretion Ofgem has ensured all decisions are fair and reasonable, taking into account the statutory framework, the relevant licence conditions, and to be reasonable in all the circumstances.

### Lack of sufficient evidence

One supplier noted that they were surprised by Ofgem's statements regarding a lack of sufficient evidence being provided to support claims. Where we have identified insufficient evidence, teams have worked to engage with SoLRs throughout the process to raise issues and request further information where appropriate to ensure that sufficient evidence is provided for us to consider. We are grateful for all SoLRs continuing

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<sup>16</sup> see *R (on the application of Scottish Power Energy Management Ltd v Gas and Electricity Markets Authority)* [2005] EWHC 2324 (Admin) paragraph 97.

<sup>17</sup> see *R (on the application of Scottish Power Energy Management Ltd v Gas and Electricity Markets Authority)* [2005] EWHC 2324 (Admin) paragraph 97.

engagement in this regard. As noted in the policy decision we published in September 2022, the consultation provided interested parties with an opportunity to make representations to us, ahead of us making our final decision. During the consultation period we engaged with SoLRs that had not submitted enough evidence initially, giving them an opportunity to provide more and better evidence for Ofgem to consider. Ofgem has carefully scrutinised the evidence provided by SoLRs in relation to each claim and where it considers the evidence provided to be insufficient, has only allowed claims if additional evidence has been provided which justifies that the costs claimed (or an element of those costs) should be approved. We believe that this was a reasonable approach to balancing the need for rigorous and robust evidence, whilst recognising the need for suppliers to be compensated for costs meeting our criteria described above as a result of acting as a SoLR.

### External Assurance

The consumer group restated the view, previously put in their response to our September policy consultation, that external assurance of all LRSP claim is required. Due to the scale of the LRSP claims, they do not believe that an internal audit is sufficient. We have decided to apply the policy decision published in September and not to require external auditing of these LRSP claims. This is because we consider that adding a requirement for external audit at this stage would be unreasonable. We will, however, consider this point ahead of any future LRSP claims.

### Status of SoLR RFI responses

We note that when suppliers respond to an RFI to become a SoLR, they may include certain requests in their response to the RFI and ask us to consider them, for example the recovery of costs over a longer period. However, while we use the information provided in responses to the information request issued at the time of the SoLR appointment to inform our decision on which supplier to appoint, this should not be seen as an endorsement of any particular requests that a supplier included in their RFI response. The supply licences provide that the SoLR would be able to make a claim to recover its reasonable incremental costs incurred in taking on the new customers where those costs are additional to the total amounts recovered from the customers for the supply where it has not waived its right to do so. We cannot give assurance, prior to the appointment of the SoLR, as to what costs can be claimed for, or over what period. The onus is on the SoLR to submit a claim that is supported by evidence and demonstrates why the amounts claimed meet the criteria for SoLR levy claims and should be allowed. Ofgem will then take all relevant information into account in deciding on whether to consent to any claim, or not, given all the circumstances of the case.

## **Reasons for decision**

### General

Ofgem's general preference is for a SoLR not to make a claim for a LRSP for costs it has incurred carrying out its role. However, we do recognise that circumstances may exist which would justify a departure from this general rule and that the costs of this claim will ultimately be paid by consumers. In our assessment of the claim, consideration has been given to the interests of current and future consumers, particularly those in more vulnerable circumstances.

Historically, some SoLRs have waived their right to make that claim through the SoLR processes. Recent SoLRs have not waived those rights as the recent costs associated with becoming a Supplier of Last Resort have been significant. In the particular



circumstances of this claim, and in line with the relevant licence conditions, we consider it appropriate to allow for the additional and otherwise unrecoverable costs summarised in Table 1 to be recovered via a LRSP.

In granting consent for this claim, the net costs incurred by the supplier acting as a SoLR in an emergency situation will be spread across all consumers, rather than borne solely by the SoLR and its customers. We consider it to be in the interest of current and future consumers to allow this claim to ensure that the consumer safety net provided by the SoLR process remains viable into the future, and the stability of the retail energy market is not further undermined to the detriment of all consumers.

### **Cost category: Credit balances**

Under SLC 9.4(b) a SoLR can claim 'any sums paid or debts assumed by the licensee to compensate any Customer in respect of any Customer Credit Balances'.

#### Decision

British Gas claimed £3,051,383.74 in compensation to ex-customers of Simplicity for their credit balances. We consider that the claimed amount is not consistent with our criteria. We have consented to British Gas claiming up to £3,024,176.70, which we consider to be a more accurate calculation of the amount of customer credit balances to be paid as part of a LRSP claim.

*Table 2: Summary of claims and decision for credit balances*

<b>Item</b>	<b>Cost</b>	<b>This claim</b>	<b>Minded-to deductions</b>	<b>Decision on deductions</b>	<b>Decision on this claim</b>
1	Credit Balances	£3,051,383.74	£27,207.04	£27,207.04	£3,024,176.70

#### Summary of Minded-to Position

British Gas requested our consent to claim £3,051,383.74 through the LRSP for the cost of refunding credit balances of customers and former customers of Simplicity held at the time the Direction was issued.

In our minded-to-position we noted that SoLRs could claim sums paid or debts assumed to compensate customers of the failed supplier in respect of customer credit balances.

We were minded-to not allow claims for the value of uncashed cheques where the SoLR had compensated customers for credit balances by sending cheques. In our minded-to position we explained that this was because we did 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 British Gas can recover the cost of any credit balance cheques presented after the cut off point for the current claim.

In our minded-to-position we considered whether the amount British Gas is seeking to claim for credit balances is otherwise unrecoverable; it may still be the case that British Gas is able to recover some of this claimed amount through the ongoing administration process for Simplicity, to which British Gas has, in accordance with the requirements of the LRSP process, submitted a subrogated creditor claim for the sums paid to compensate customers for credit balances. In our minded-to-position we noted that, as we propose to make our decision on the claim ahead of the conclusion of the liquidation process, the timescale of which is uncertain, we were minded to approve this element of the claim, subject to the outcome of the Simplicity liquidation process.

### Summary of Consultation Responses

We received one stakeholder response from British Gas on our minded-to-position on credit balances. It supported our stance of allowing all credit balances refunded to customers to be reclaimed via the levy. It also stated that it supports the pragmatic approach for uncashed cheques that will allow it to claim any issued cheques that are cashed by customers in the future.

### Reasons for decision

British Gas requested our consent to recover £3,051,383.74 for the cost of refunding credit balances to some former customers of Simplicity. In our minded-to position, Ofgem stated that in principle we are minded-to allow the claim, with a deduction for the value uncashed cheques. In their consultation response, British Gas said that it supported our stance of allowing all credit balances refunded to customers to be reclaimed via the levy and that it supported the pragmatic approach for uncashed cheques that will allow it to claim any issued cheques that are cashed by customers in the future. We have considered the consultation response, noting British Gas' support for our approach.

We are satisfied that the claim is consistent with our criteria and have decided to consent to a LRSP claim of **£3,024,176.70** for sums paid to compensate customers for credit balances, with a deduction of £27,207.04 for uncashed cheques.

### **Recovery of LRSP claim**

British Gas will be paid the amounts specified in the Ofgem's consent documents, published alongside this letter, by the relevant licensed gas and electricity network operators. This will be recovered by the network operators in proportion to the total number of nationwide gas and electricity supply points.

Yours faithfully,

**Neil Lawrence**  
**Director of Retail**