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20 December 2022

Dear Colleague

Last Resort Supply Payment Claim from Octopus Energy

On 7 October 2022, Octopus Energy Limited ("Octopus Energy") submitted a claim for a Last Resort Supply Payment (LRSP) for Ofgem's consent under Supply Licence Standard Licence Condition (SLC) 9. Octopus Energy is seeking to recover additional costs incurred in complying with a Last Resort Supply Direction¹ to act as Supplier of Last Resort (SoLR) to customers of the former UK Energy Incubator Hub Limited ("UKEIH").

Decision to consent

Following our assessment of the evidence provided, and taking into account the results of our internal assurance process, on 20 December 2022 Ofgem consented to Octopus Energy making a LRSP claim of up to **£236,558.00**.

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

- other costs reasonably incurred on becoming a SoLR.

In our policy decision on the 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.

¹ <https://www.ofgem.gov.uk/publications/appointment-octopus-energy-limited-electricity-supplier-last-resort-uk-energy-incubator-hub-ltd> and <https://www.ofgem.gov.uk/publications/appointment-octopus-energy-limited-gas-supplier-last-resort-uk-energy-incubator-hub-ltd>

As part of that faster multiple-claim levy process, we have made our consent to this initial claim conditional upon the SoLR entering into a True-up Agreement with Ofgem. Under that True Up Agreement, Octopus Energy will submit full details, including any reconciliation of all of its costs once they are fully incurred and known. This will need to include all supporting evidence in line with the SoLR's obligations under the True-up Agreement and Ofgem's policy decisions in September 2022,² and as outlined in the True-up Agreement that Octopus Energy enters into with Ofgem. We expect Octopus Energy to obtain an independent audit of those full details and board sign off before making any further claim. If there is any reduction in these costs, we will set them off against Octopus Energy's subsequent claim. In the highly unlikely event that the subsequent claim is not sufficient for that set off to be made, Octopus Energy will agree to repay any net overpayment back to consumers.

We have assessed this LRSP claim in accordance with our policy decision on the true-up process, published 21 September 2022³, and consistent with our published *Guidance on supplier of last resort and energy supply company administration orders*.⁴ In addition, in making this decision, we have had regard to Ofgem's principal objective of protecting the interests of current and future energy consumers⁵, the public sector equality duty⁶ 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 Octopus Energy's 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 them⁷. 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.

² [Decision on last resort levy claims true-up process | Ofgem](#)

³ <https://www.ofgem.gov.uk/publications/decision-last-resort-levy-claims-true-process>

⁴ https://www.ofgem.gov.uk/system/files/docs/2016/10/solr_revised_guidance_final_21-10-2016.pdf

⁵ s4AA Gas Act 1986 and s3A Electricity Act 1989

⁶ *Equality Act 2010* Part 11 Sections 149 to 157 [Equality Act 2010 \(legislation.gov.uk\)](#)

⁷ See section 4AA (1A) (b) Gas Act 1986 and section 3A (1A) (b) of the Electricity Act 1989

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 electricity⁸.

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"⁹ 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 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 9¹⁰ 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 Direction¹¹. Ofgem's subsequent exercise of that discretion cannot 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.

⁸ See Supplier SLC 8(1)(b)

⁹ [Supplier of Last Resort: Revised Guidance 2016 | Ofgem](#)

¹⁰ See in particular Supplier SLC 9.5 and 9.6

¹¹ 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.

Failed Supplier event

On 9 July 2022, we appointed Octopus Energy as the SoLR for UKEIH gas¹² and electricity¹³ customers. This followed an appointment process aimed at getting the best deal for consumers. We outlined the material factors behind our decision to appoint Octopus Energy as the SoLR to those customers in our decision letter published on 1 December 2022¹⁴.

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 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.

Multi-stage claims

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. SoLRs may then follow this claim with a subsequent claim (or claims) for

¹² <https://www.ofgem.gov.uk/publications/appointment-octopus-energy-limited-gas-supplier-last-resort-uk-energy-incubator-hub-ltd>

¹³ <https://www.ofgem.gov.uk/publications/appointment-octopus-energy-limited-electricity-supplier-last-resort-uk-energy-incubator-hub-ltd>

¹⁴ <https://www.ofgem.gov.uk/publications/appointment-octopus-energy-limited-supplier-last-resort-uk-energy-incubator-hub-limited>

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 during the relevant period. SoLRs entered into a 'True-up Agreement' with Ofgem to support the faster process. Initial claim consents, subsequent claims and true-up claims are conditional on SoLRs complying with 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 2022¹⁵ that set out our policy decisions on the approaches SoLRs should take with regards to these true-up claims. We applied these policies in reaching our decision on this new initial claim. To reduce the risk of overpayment, we expect the initial claim only to include costs that have actually been incurred and can be fully evidenced in the period after appointment as SoLR.

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 Octopus Energy, Ofgem's previously published policy decisions, and its own knowledge of the energy markets. 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.

In reaching its decision Ofgem carried out:

- a. A quantitative check of Octopus Energy's methodology for each cost item claimed. This included determining how each total cost item was calculated based on data sent to us by Octopus Energy and ensuring these costs were in line with commitments Octopus Energy 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 other costs in accordance with our criteria and methodology, set out below.

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

- **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 Octopus Energy's claim

Octopus Energy indicated at the time of our SoLR appointment process that it would not waive its right to make a claim for a LRSP for additional costs incurred as a result of acting as the SoLR for customers of UKEIH.

Summary of decision

Ofgem has consented to Octopus Energy claiming a LRSP of up to **£236,558.00** conditional on Octopus Energy entering into a binding True-up Agreement with Ofgem in respect of the Last Resort Supply Direction.

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 | Decision on deductions | Decision on this claim |
|---------------|---|-------------|------------------------|------------------------|
| 1 | Other costs: Administrator costs; IT costs. | £236,558.00 | £0 | £236,558.00 |
| Total: | | | | £236,558.00 |

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 bidding 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.

Condition

Ofgem has made its consent to this LRSP claim conditional on Octopus Energy entering into a binding True-up Agreement with Ofgem in respect of the Last Resort Supply Direction.

Cost category: "Other costs"

When a SoLR goes through the process of onboarding customers of failed suppliers, we understand that as part of this process the SoLR may incur costs which could, for example, include administrator or operational costs. As part of the LRSP, SoLRs may seek to claim these other costs incurred. Octopus Energy requested our consent to claim for £236,558.00 in other costs they incurred in transitioning former customers of UKEIH to Octopus Energy. We have used the criteria set out in our published policy decision on the last resort levy claims True-up process to assess whether these costs are appropriate and can be recovered through a LRSP.

Octopus Energy claimed **£236,558.00** in other costs incurred as a result of complying with the Last Resort Supply Direction. We consider that the claimed amount is consistent with our criteria. We have consented to Octopus Energy claiming that amount as part of a LRSP.

Table 2: Summary of claims and decision for other costs

| Item | Cost | This claim | Decision on deductions | Decision on this claim |
|------|---------------------|--------------------|------------------------|------------------------|
| 1 | Administrator Costs | £200,000.00 | £0 | £200,000.00 |
| | IT Costs | £36,558.00 | £0 | £36,558.00 |
| | Total: | £236,558.00 | £0 | £236,558.00 |

Administrator Costs

Rationale for decision:

Octopus Energy requested our consent to claim £200,000.00 for Administrator costs incurred when onboarding former customers of UAEIH. Octopus Energy had provided sufficient evidence, including invoices and rationale for how these costs were agreed to support their claim and satisfy us that these costs were additional, directly incurred as part of the SoLR role, otherwise unrecoverable, unavoidable and efficient in relation to Octopus Energy's role as a SoLR for UAEIH.

We recognise that working with the administrator of a failed supplier and having transitional service agreements in place was required to allow successful transfer of customers from UAEIH and these costs were incurred as a direct result of Octopus Energy acting as a SoLR, were additional and otherwise unrecoverable. Therefore, based on the information submitted as part of the claim and within the particular circumstances of this case, we consider it reasonable to allow Octopus Energy to recover these costs and we have approved the full amount claimed.

IT Costs

Rationale for decision:

Octopus Energy requested our consent to claim £36,558.00 for IT costs incurred when migrating former customers of UAEIH to Octopus Energy. Octopus Energy provided evidence to support their claim, which included invoices and an explanatory narrative for the process it undertook.

We are satisfied that our assessment of the claim is thorough and fair. Octopus engaged with us during the assessment phase and where we requested further information during the assessment Octopus Energy supplied this and answered any questions we had regarding the claim.

Having considered the evidence submitted to us, we are satisfied that the costs were additional, directly incurred as part of the SoLR role, otherwise unrecoverable, unavoidable, and efficient. Therefore, based on the information submitted as part of the claim and within the particular circumstances of this case, we consider it reasonable to allow Octopus Energy to recover these costs and we have approved the full amount claimed.

Recovery of LRSP claim

Octopus Energy 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