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20 December 2022

Dear Colleague

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

On 7 October 2022, Shell Energy Retail (SERL) submitted a claim for a Last Resort Supply Payment (LRSP) for Ofgem's consent under Supply Licence Standard Licence Condition (SLC) 9. SERL 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 GoTo.

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 Ofgem consented to SERL making a LRSP claim of up to £12,360,037.21.

This letter is the notice of reasons for Ofgem's decision to consent to SERL making a LRSP claim from relevant network operators. Our decision will allow SERL to claim for costs 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 SERL;
- financing costs incurred on becoming a SoLR;
- other costs reasonably incurred on becoming a SoLR.

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<sup>1</sup> Appointment of SERL Energy Retail Limited as Supplier of Last Resort for Goto Energy (UK) Limited | Ofgem

<sup>2</sup> SOLR Levy - Minded to position for consultation - SERL - GoTo.pdf (ofgem.gov.uk)

We have assessed this LRSP claim in accordance with our policy decision on the true-up process, published 21 September 2022<sup>3</sup>, and consistent with our published *Guidance on supplier of last resort and energy supply company administration orders*.<sup>4</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>5</sup>, the public sector equality duty<sup>6</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 SERL'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 them<sup>7</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>8</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>9</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

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

<sup>4</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>5</sup> s4AA Gas Act 1986 and s3A Electricity Act 1989

<sup>6</sup> *Equality Act 2010* Part 11 Sections 149 to 157 [Equality Act 2010 \(legislation.gov.uk\)](https://www.legislation.gov.uk/ukpga/2010/154/part_11)

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

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

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

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 9<sup>10</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>11</sup>. 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.

### Failed Supplier event

On 21 October 2021, we appointed SERL<sup>12</sup> as the SoLR for GoTo 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 SERL as the SoLR to those customers in our decision letter published on 29 November 2022<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

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<sup>10</sup> See in particular Supplier SLC 9.5 and 9.6

<sup>11</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>12</sup> Ofgem appoints SERL Energy Retail Limited to take on customers of GOTO Energy | Ofgem

<sup>13</sup> Link: Direction to Appoint SERL Energy Retail Limited as Gas Supplier of Last Resort to Goto Energy (UK) Limited | Ofgem

<sup>14</sup> Link: Direction to appoint SERL Energy Retail Limited as Electricity Supplier of Last Resort to Goto Energy (UK) Limited | Ofgem

<sup>15</sup> Link: Appointment of SERL Energy Retail Limited as Supplier of Last Resort for Goto Energy (UK) Limited | Ofgem

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 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 2022<sup>16</sup> that set out our policy

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

decisions on the approaches SOLRs should take with regards to these true-up claims. We applied these policies in order to reach our minded-to position on this claim, which we published for consultation on 4 November 2022.

#### 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 SERL, 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. SERL 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 SERL 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 SERL methodology for each cost item claimed. This included determining how each total cost item was calculated based on data sent to us by SERL and ensuring these costs were in line with commitments SERL 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;
  - d. Review and assurance of the calculations made in the published minded-to position; and
  - e. A qualitative and quantitative assessment of the claim for costs related to wholesale costs, credit balances, financing and other costs 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 SERL's claim*

SERL indicated at the time of our SoLR appointment process that it would not waive its right to make a claim for a 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(s) were consented to on 17 December 2022. Consistent with the terms of that consent and the True-up Agreement between SERL and Ofgem, we have taken that claim into consideration in reaching our decision on this claim.

#### **Summary of decision**

Ofgem has consented to SERL claiming a LRSP of up to £12,360,037.21 conditional on SERL confirming that this claim is a Subsequent Levy Claim for the purposes of the True-up Agreement and that the terms of the True-up Agreement continue to apply to this and subsequent claims 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	Initial Claim Approved	True-Up claim (this claim)	Minded-to deductions on this claim	Decision on deductions for this claim	Amount approved for this claim
1	Wholesale	£13,017,472.11	£15,421,652.89	£6,131,136.15	£6,199,815.39	£9,221,837.50
2	Credit balances	£0.00	£873,807.62	£0.00	£0.00	£873,807.62
3	Working capital	£0.00	£2,227,225.36	£0.00	£0.00	£2,227,225.36
4	Other costs	£0.00	£197,581.50	£160,414.77	£160,414.77	£37,166.73
Total:						£12,360,037.21

#### **Reasons for decision**

**The Office of Gas and Electricity Markets**

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[www.ofgem.gov.uk](http://www.ofgem.gov.uk)

## **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. 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 stakeholders. We note several general points made by suppliers on the wider SoLR levy process, including the potential for further claims, and concerns regarding the policy decision to limit the additional, otherwise unrecoverable, wholesale costs that SoLRs can claim to the cost of energy delivered by the end of March 2022, or within six months of being appointed, whichever is later, the latter of which we have responded to in the wholesale section of this document. s. We have expanded below upon each general issue raised in consultation responses to the minded to position.

### **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>17</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>18</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 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.

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<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.

<sup>18</sup> see *R (on the application of Scottish Power Energy Management Ltd v Gas and Electricity Markets Authority)* [2005] EWHC 2324 (Admin) paragraph 97.



### Further claims

Several suppliers voiced their view that further LRSP claims should be permitted, generally to allow further reconciliation of wholesale costs incurred. The possibility of further claims was echoed by the consumer group, which considered that further claims may be required to ensure that SoLRs are not overcompensated. However, the consumer group also pointed to the clear commercial incentive SoLRs have to use any further claims to argue that they have been undercompensated.

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 SERL and Ofgem, Subsequent Levy Claims may be made following the Initial Levy Claim and before a final True-up claim. As set out in the consultation for this claim, we were minded to consider this claim to be a Subsequent Levy Claim for the purposes of the True-up Agreement.

Following the consultation on this claim, we consider that this remains a reasonable approach. Accordingly, Ofgem has made its consent to this LRSP claim conditional on confirmation by SERL that this claim is a Subsequent Levy Claim for the purposes of the True-up Agreement and that the terms of the True-up Agreement continue to apply. This includes an obligation to submit true-up information as requested and to refund any amounts by which SERL has been overcompensated by a LRSP.

This would mean that the final True-up claim under the True-up Agreement will be made next year or later. This will allow additional time for suppliers to provide additional supporting evidence for the limited instances where we have specified that our decision on certain costs is not final. In addition, this will allow additional time to make the final True-Up decision to ensure that the benefit of any monies recovered from the administrators of the failed suppliers can be utilised for consumers' benefit.

For the avoidance of doubt, unless we have specified otherwise in respect of certain costs suppliers are seeking to claim, our decision on each Subsequent Levy Claim is a final decision, and we do not expect suppliers to seek to revisit those final decisions.

We have made clear in this decision where we consider that we have not yet made a final decision on a particular element of this subsequent claim; and/or where we expect to make a revision to the amounts approved here under the True Up Deed (or amended or otherwise varied consent), especially should additional evidence be forthcoming or once additional validations have taken place.

### 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.

### 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.

### Condition

Ofgem has made its consent to this LRSP claim conditional on confirmation by SERL that this claim is Subsequent Levy Claim for the purposes of the True-up Agreement between SERL and Ofgem and that the terms of the True-up Agreement continue to apply to this and subsequent claims in respect of the Last Resort Supply Direction. We have made this decision because it has the effect of allowing additional time to finalise claims for LRSPs following multiple Last Resort Supply Directions in difficult market conditions. We consider that it will enable suppliers to provide additional supporting evidence for costs that have not yet been approved by Ofgem, as well as allowing Ofgem to ensure the benefit of any monies recovered from the administrators of the failed suppliers can be utilised for consumers' benefit.

### **Cost category: Wholesale**

In our published decision on the claims true-up process<sup>19</sup> we explained that all SoLRs appointed in the period from September – December 2021 should be able to recover additional and otherwise unrecoverable wholesale costs reasonably incurred as part of the SoLR role relating to energy delivered up until 31 March 2022 or until the end of their 6-month SoLR direction, whichever is later. This has been necessary largely as a result of a period of extreme wholesale energy price volatility and record high prices seen, resulting in wholesale direct fuel costs often far exceeding those assumed in the

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<sup>19</sup> [Decision on last resort levy claims true-up process | Ofgem](#)

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 assessment we have analysed the information provided by suppliers, to:

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

The SERL true-up claim submitted on 07 October 2022 includes £15,421,652.89 in wholesale costs. Following the above assessments, and having considered the responses received to our minded to position consultation, as well as carrying out further assurance of our own calculations we consider that the claimed amount is not fully consistent with our criteria and we have decided to consent to the claim with the following deductions:

- A deduction of £563,697.05 has been made for GoTo as part of our final decision for the revenue received from SoLR customers in respect of the Backwardation allowances in the price cap. Our final decision is adjusted from our minded to position for the reasons set out in the following sections.
- A deduction of £371,546.12 has been made for GoTo as part of our final decision 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. Our final decision is unchanged from our minded to position, other than a small adjustment to reflect rounding.
- A deduction of £17,360.45 has been applied to short-term trades and gas shipper trades, for the reasons set out in the relevant section below. We have used a comparator including wholesale allowances for these costs, rather than SERL's comparator which excluded wholesale allowances.
- We have decided to deduct a further amount in relation to the cost of hedges made after initial hedges were put in place. On the basis of evidence and discussions to date, we consider that there is insufficient evidence that all of SERL's trades meet all of our criteria. A more detailed explanation of our decision has been redacted from this document for reasons of confidentiality. Given the

complexity of this topic we intend to conduct further work to establish an appropriate level of claim, which will take place in 2023. In the meantime, we have decided to deduct £5,247,211.77 from SERL's claim, in line with the minded-to position, noting that we anticipate a further true-up claim next year to reconcile payment to the final calculated amount. The deducted value differs from the minded-to value of £5,247,218.67 due to corrections for rounding errors in the calculations used.

The final total deduction for GoTo is £6,199,815.39, which is £68,679.24 higher than the proposed deduction of £6,131,136.15 in the minded-to decision. This results in a net wholesale true-up claim of £9,221,837.50, as opposed to £9,290,516.74 set out in the minded-to decision. When accounting for the initial claims made in December 2021, the total wholesale costs approved are £22,239,309.61, as opposed to £22,307,988.85 set out in the minded-to decision.

*Table 2: Summary of wholesale costs*

Item	Cost	Initial Claim	True-up claim	Deduction Category	Deduction amount (minded-to)	Deduction amount (final decision)	Minded-to position on claim	Final position on claim
1	Wholesale	£13,017,472.11	£15,421,652.89	Backwardation	£495,451.06	£563,697.05		
				Contracts for Difference	£371,308.10	£371,546.12		
				Correct comparator for short-term trading	£17,158.32	£17,360.45		
				Incremental hedging costs	£5,247,218.67	£5,247,211.77		
							£9,290,516.74	£9,221,837.50

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

## **Backwardation**

### **Summary of minded to position**

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 winter 2021/22, 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, and a further allowance of £6 per customer was introduced in August 2022, to be recovered in the year from 1 October 2022.

In our minded to decision, the relevant backwardation deduction for each supplier was 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 noted that we preferred 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 preferred it 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.

### **Summary of consultation Responses**

In relation to the standardised backwardation deduction, three suppliers that responded to our consultation confirmed that they understood and did not oppose the rationale for making this deduction in principle. Respondents raised challenges regarding the specific demand-base used, suggesting that this would overstate the revenue that would be recovered under the backwardation allowance. One supplier questioned whether the deduction was consistent with Ofgem's decision not to allow claims for costs relating to supply after the six-month direction period.

Specifically in relation to this claim one supplier noted that Ofgem's calculation assumed that there would be no churn until September 2023. If, in contrast, customers were to move away, then it would not recover the full amount that Ofgem proposed to deduct from the claim. Given this, it proposed that rather than making the backwardation deduction now, this should instead be addressed in a subsequent true-up process.

### **Reasons for our decision**

We have decided to deduct an amount from SERL's claim to reflect the backwardation allowances in the cap, for the reasons set out in our minded-to position.

In relation to the supplier's proposal that the deduction should be deferred until 2023, we are concerned that such an approach would create a risk that suppliers are

overcompensated via the levy process, such that customers would end up paying more via SoLR levy charges in next year's network charges than is necessary. Therefore, we have decided not to change our approach to reflect the supplier's proposal.

Subsequent to publishing the minded-to letter, Ofgem has also made an adjustment to ensure that the backwardation deduction better matches the intent of our policy position. Our standardised approach has been to take the forecast demand of the customers taken on by the SoLR for winter 2021/22 or Q1 2022 (depending on the date of the SoLR), and then dividing this by an estimate of the share of total annual demand taking place in that period to derive an annualised figure. In our minded-to position, for the backwardation deduction calculated for GoTo Energy, we identified through assurance checks that we had inadvertently taken the sum of demand over a period other than Q1 2022 for electricity (using February to April). In our final decision, the forecast electricity customer demand for GoTo Energy claim has been adjusted to reflect the accurate Q1 2022 period. This also ensures that our final decision aligns with how the backwardation deductions have been calculated for other SoLRs.

We note that, in calculating the backwardation deduction for the minded-to decision, Ofgem relied on inputs which were rounded to different numbers of decimal places. For consistency, we have for our final decision used unrounded inputs, as they appear in the relevant workbook submitted by suppliers alongside their claim, or annex to the default tariff cap. This results in small adjustments to backwardation deductions for all claims.

Finally, we have decided that it will be open to SoLRs to submit a further claim in 2023 in relation to the backwardation deduction if they consider that new evidence exists to support such a claim. We note that an important consideration in assessing any such claim will be the extent to which it is appropriate to base the amount to be deducted on outturn demand, rather than seasonally normal demand (given the potential inconsistency with how costs for winter 2021/22 have been treated).

## **CfD**

### **Summary of minded-to position**

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 for suppliers (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,<sup>20</sup> which are in turn based on forward prices observed at that time of the forecast.

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 for the customers of the failed suppliers which were well in excess of the direct fuel allowances included in the cap. However, increases in wholesale electricity prices also resulted in CfD costs for those customers that were significantly lower than the relevant allowance in the cap.

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<sup>20</sup> [August 2021, Default tariff cap, Annex 4](#)

As we set out in our February 2022 price cap decision 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 risk earlier in 2021, when wholesale prices were lower. However, we consider that this is unlikely to apply to SoLR customers. This is because, where a supplier hedged their CfD exposure for SoLR customers, this would have been at much higher wholesale prices given the timing of the SoLRs, locking in a lower CfD cost than included in the cap. And where a supplier did not hedge, they would have realised the outturn CfD cost – which given high Day Ahead wholesale prices would have been a net payment back to the SoLR in question through the CfD scheme.

To avoid SoLRs over-recovering in relation to wholesale costs of their SoLR customers, we were therefore minded to deduct an amount from claims equivalent to the demand-weighted interim levy rate component of the default tariff cap for period 7 multiplied by the volume of electricity being claimed for, on the basis that the revenue generated under the CfD allowance would have offset the wholesale costs incurred by suppliers.

In relation to the standardised CfD deduction, three suppliers that responded to our consultation confirmed that they understood and did not oppose the rationale for making this deduction, and one supplier did not comment on this deduction. Some respondents raised challenges at the demand-base used, where hedging strategies meant that CfD deductions would be higher than expected. One supplier questioned if the CfD deduction was consistent with the rest of the price cap, and that Ofgem were being selective about deductions made when some elements of the price cap may adversely affect suppliers.

#### Summary of consultation responses

In relation to the standardised CfD deduction, three suppliers that responded to our consultation confirmed that they understood and did not oppose the rationale for making this deduction, and one supplier did not comment on this deduction. Some respondents raised challenges at the demand-base used. One supplier questioned if the CfD deduction was consistent with the rest of the price cap, and that Ofgem were being selective about deductions made when some elements of the price cap may adversely affect suppliers.

One supplier believes the methodology used to calculate the CfD deduction is inconsistent with the rest of the price cap. It told us that it had previously submitted to Ofgem in relation to the CfD allowance in the price cap that suppliers may not be fully compensated for all costs incurred depending on levels of adjustment and each supplier's position. As Ofgem did not seek to offset the CfD allowance for non-SoLR customers over the same period (i.e. winter 2021/22), the supplier questioned why the position of SoLR customers should be any different.

#### Reasons for decision

We disagree with the supplier's view that the CfD deduction we have made is inconsistent with the price cap methodology. In particular, as we set out in our 4 February 2022 decision on the potential impact of increased wholesale volatility on the



default tariff cap,<sup>21</sup> for non-SoLR customers, a benefit resulting from CfD charges that were lower than those assumed in the cap was not realised in most cases, as suppliers had hedged their CfD exposure earlier in 2021, when wholesale prices were lower. Therefore we did not seek to include an offset for CfD benefits when considering retrospective adjustments to the price cap to allow suppliers to recover additional amounts relating to wholesale costs in winter 2021/22.

In contrast, we consider that this is unlikely to apply to SoLR customers. In particular, where a supplier hedged their CfD exposure for their SoLR customers, this would have been at much higher wholesale prices given the timing of the SoLRs, locking in a lower CfD cost than included in the cap (or even a benefit). And where a supplier did not hedge, they would have realised the outturn CfD cost – again, significantly below the allowance included in the cap.

Given this, we consider it necessary to make the CfD deduction to ensure that suppliers are not over-recovering and all costs passed onto consumers are both fair and reasonable.

Finally, we note that in calculating the CfD deduction for the minded-to decision, Ofgem relied on inputs which were rounded to different numbers of decimal places. For consistency and greater accuracy, we have for our final decision used unrounded inputs, as they appear in the relevant annex to the default tariff cap. This results in small adjustments to the CfD deductions for all claims.

## **Short-term trades to cover immediate energy need and Gas Shipper Costs**

### **Summary of minded-to position**

The amount claimed by SERL for wholesale costs included trades to fulfil SoLR customers' immediate energy requirements, in the period between appointment and the beginning of the next traded month. In our minded-to decision, we set out our view that it was appropriator suppliers to claim for these costs, however we considered that the offsetting revenue that SoLRs should assume to have been recovered from customers in relation to these costs should include the various wholesale allowances that are included in the cap, not just the direct fuel cost component. This is because we expected only limited further costs to be incurred in relation to these trades.

We were therefore minded to deduct £17,158.32 from the claim to account for the use of a comparator including additional cap allowances for shaping and imbalance, transactions costs and basis risk allowance amounts which were not taken into account by SERL when considering revenue recovered from customers for these volumes.

In relation to SERL's claim, we also noted that a significant volume of within-day and day-ahead gas trades appeared in the claim for delivery during Q4 2021, which had been classified by SERL as 'shipper costs'. We described our view that the appropriate treatment of these costs was uncertain based on the information given. In principle we

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<sup>21</sup> [Decision on the potential impact of increased wholesale volatility on the default tariff cap, February 2022](#)

were minded to allow these costs subject to receiving further explanation and evidence that satisfied us as to the validity of these trades and how they met our previously stated principles, including justification for the correct comparator being used for revenue recovered from customers. Therefore, in our minded-to position we did not make any further deductions regarding these costs.

### Consultation Responses

In its consultation response, SERL stated that it believes that it is only consistent to use a wholesale allowance in the cap including shaping and imbalance allowances where the short-term trades are consented to. It said that it had not sought to use a different comparator for these trades because Ofgem had provided a template that only allowed one wholesale number to be referenced against.

SERL noted its surprise that Ofgem required further evidence to establish whether costs such as shipper costs were within the scope of the wholesale claim. SERL believes it is appropriate to include gas shipper costs as these were directly caused by the SoLR appointment and SERL couldn't act as a shipper immediately following appointment due to the time taken to migrate customers on central systems. SERL noted that given the complexities involved, the decision that they took internally was that this was the best means of mitigating risks to the SoLR customers. SERL also submitted additional documentary evidence regarding gas shipper costs, including invoices demonstrating the costs incurred.

Another supplier remarked that including short-term trades classed as shipper costs for SERL would result in the claim being higher compared to other claimants. This supplier was concerned about ensuring costs claimed are in line with those that Ofgem is minded to allow for other suppliers.

### Reasons for our decision

We agree that Ofgem must ensure a consistent approach, and we have assessed all claims using the same criteria. At the same time, as set out in our September policy decision, each case has been assessed on a case-by-case basis,<sup>22</sup> reflecting the specific circumstances of that claim and the evidence received. To reach its decisions Ofgem has thoroughly reviewed all evidence and responses from other parties submitted and will only accept costs which are reasonable in all of the circumstances, including meeting the principles as published in the September 2022<sup>23</sup> documentation.

Following review of the additional evidence received from SERL, we are satisfied that it is appropriate to allow the gas shipper costs including in SERL's claim, as these were unavoidable and incurred directly due to the SoLR. This decision is subject to the adjustments set out below.

Having reviewed the evidence submitted, we have decided to extend the amendment to the comparator used for the initial set of short term trades to the full set of short-term

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<sup>22</sup> Page 15: [Decision \(ofgem.gov.uk\)](#)

<sup>23</sup> [Decision on last resort levy claims true-up process | Ofgem](#)

trades claimed by SERL (ie including the totality of gas shipper costs appearing in SERL's claim for Q4 2022). This is because we expect only limited further shaping or other costs to have been incurred in relation to these trades. After applying the change to the comparator price for these additional trades, the total deduction increases compared to that set out in our minded-to decision, resulting in a total deduction of £17,360.45.

As set out below, we intend to conduct further work in relation to SERL's hedging costs in 2023. It is possible that this will require further evidence and/or clarification of existing evidence from SERL. We note that the treatment of SERL's shipper trades could be amended as part of this work, given interactions between these two sets of costs.

Finally, we note that in calculating the deduction for the short term trading comparator for SERL in the minded-to decision, Ofgem relied on direct fuel cost allowances which were rounded to different numbers of decimal places. For consistency, we have for our final decision used unrounded inputs, as they appear in the relevant annex to the default tariff cap. This results in a small adjustment to the deduction compared to the value set out in the minded-to position.

### **Incremental hedging costs and Unexpected Demand**

#### **Summary of minded-to position**

In our minded to decision, we noted that there were claims which included costs incurred in relation to incremental hedging for additional demand which took place some time after being appointed as the SoLR. We understood these 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 2022<sup>24</sup> to allow suppliers to recover the costs associated with procuring energy for unexpected and unhedged default tariff customers. We acknowledged in the minded to that for some suppliers, costs of a similar nature may have arisen with respect to SoLR customers, and may have exceeded the allowances included in the cap.

SERL's claim includes significant costs associated with hedging which occurred significantly after the date SERL had been appointed as a SoLR. In our minded-to letter, we found that the evidence submitted by SERL did not meet the expected standard and were minded to disallow that element of SERL's claim. The disallowed element was calculated by repricing volumes traded after a particular date at prices reflective of those if trades had been earlier. This resulted in a minded-to deduction of £5,247,218.67 for SERL .

#### **Summary of consultation responses**

In addition to its consultation response, SERL has submitted further evidence to substantiate its claim that incremental hedging costs should be included fully in the wholesale claim. We have reviewed this evidence and held further discussions with SERL on the subject. We have requested and received further evidence from SERL in order to fully understand the circumstances of their claim.

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<sup>24</sup> <https://www.ofgem.gov.uk/publications/price-cap-decision-potential-impact-increased-wholesale-volatility-default-tariff-cap>

In its consultation response and subsequent evidence, SERL has set out a timeline describing its hedging process. A more detailed summary of that timeline has been redacted from this document for reasons of confidentiality.

#### Reasons for our decision

On the basis of evidence and discussions to date, we do not consider it appropriate for SERL to claim these costs<sup>25</sup>. Specifically there is insufficient evidence that SERL made all reasonable efforts to accurately forecast demand for SoLR customers.

In paragraph 4.4 of Ofgem's SoLR guidance (2016) we say:

*"When determining the amount of gas or electricity a customer has used, a SoLR must act on a reasonable basis, taking into account available consumption data for the premises in questions and other relevant factors."*

Also, in paragraph 4.8 of Ofgem's SoLR guidance (2016), taken from Clause 8.8 of the Standard Licence Conditions, we say:

*"In purchasing any additional gas or electricity in order to supply its newly acquired customers, the SoLR should take all reasonable steps to do so as economically as possible under the circumstances"*

Amongst other things, we evaluate all claims against our economic principle:

*"Economic: whether the SoLR made all reasonable efforts to avoid the cost in the first instance or absorb the cost"*

In assessing SERL's claim, we have determined that these criteria have not all been met for some trades. A more detailed explanation of the reasons for our decision has been redacted from this document for reasons of confidentiality. Given the complexity of this topic, we intend to conduct further work to establish an appropriate level of the deductions to the claim, which will take place in 2023. It is possible that this will require further evidence and/or clarification of existing evidence from SERL. In the meantime we have decided to deduct £5,247,211.77 from SERL's claim. This deduction is based on a re-valuation of later hedges at representative prices which SERL had achieved in their earlier hedging, where available. We consider that at this stage this is an appropriate and reasonable deduction and anticipate refining these calculations as part of the further work described above, taking into account any additional evidence we receive. As such we anticipate a further true-up claim next year in order to reconcile payment to the final calculated amount (which may be higher or lower than the current deduction). The deducted value differs from the minded-to value of £5,247,218.67 due to corrections for rounding errors in the calculations used.

#### **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'.

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<sup>25</sup> In line with Clause 9.5 of the Standard Licence Conditions for electricity and gas

### Decision

SERL claimed £873,807.62 in compensation to ex-customers of Go To Energy for their credit balances. We consider that the claimed amount is consistent with our criteria. We have consented to SERL claiming £873,807.62 for sums paid to compensate customers for credit balances.

*Table 3: Summary of claims and decision for credit balances*

<b>Item</b>	<b>Cost</b>	<b>Initial Claim</b>	<b>This claim</b>	<b>Minded-to deduction s</b>	<b>Decision on deduction s</b>	<b>Decision on this claim</b>
2	Credit Balances	£0	£873,807.62	£0	£0	£873,807.62

### Summary of minded-to position

SERL requested our consent to claim £873,807.62 through the LRSP for the cost of refunding credit balances of customers and former customers held at the time the Go To Energy direction was issued.

In our minded-to-position we noted that SoLR 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 SERL 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 SERL is seeking to claim for credit balances is otherwise unrecoverable; it may still be the case that SERL is able to recover some of this claimed amount through the ongoing administration process for Go To Energy, to which SERL 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 GoTo Energy liquidation process.

There were no uncashed cheques for GoTo.

### Summary of consultation responses

SERL did not comment on this aspect of their claim in their consultation response. We received one stakeholder responses from British Gas to our minded-to-position on credit balances. British Gas stated that it supported our stance of allowing all credit balances refunded to customers to be reclaimed via the levy. It also stated 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.

#### Reasons for decision:

SERL requested our consent to recover £873,807.62 for the cost of refunding credit balances to some former customers of Go To Energy. In our minded-to position, Ofgem stated that in principle we are minded-to allow the claim. We have considered the responses, noting that no objections were raised to the approach and one supplier noted their support for this approach. We are satisfied that the claim is consistent with our criteria and have decided to consent to a LRSP claim of £873,807.62 for sums paid to compensate customers for credit balances.

#### **Cost category: Working capital**

The policy decision on last resort levy claims true-up process<sup>26</sup> explained what would be required for SoLRs to claim for financing or working capital costs incurred. The policy decision also set out the requirement for suppliers to 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.

#### Decision:

SERL claimed £2,227,225.36 for the cost of working capital, followed by a revised claim totalling £2,272,364.24. The calculation includes costs incurred to reflect actual costs incurred and the timescale for the recovery of those costs as set out in our published policy decision.

Our decision is to provisionally consent to SERL's claim of £2,227,225.36 for working capital costs incurred in acting as SoLR for GoTo. We expect to make our final decision on the value of working capital to be allowed to SERL in relation to acting as SoLR for GoTo next year. This is discussed further in the 'decision' section, below.

*Table 4: Summary of claims and decision for working capital*

<b>Item</b>	<b>Cost</b>	<b>Initial Claim</b>	<b>True-up claim</b>	<b>Revised true-up</b>	<b>Minded-to deduction</b>	<b>Decision on deduction</b>	<b>Decision on this claim</b>
3	Working capital	£0.00	£2,227,225.36	£2,272,364.24	£0.00	£0.00	£2,227,225.36

<sup>26</sup> <https://www.ofgem.gov.uk/sites/default/files/2022-09/Decision%20on%20the%20last%20resort%20levy%20claims%20true-up%20process.pdf>

### Summary of minded-to position

Prior to their original submission on 7<sup>th</sup> October 2022, SERL commented on the non-wholesale costs template we had provided to suppliers to submit the non-wholesale elements of their claims, raising concerns with the approach proposed in the template for the Working Capital category. Further detail on the representation made by SERL have been redacted for confidentiality purposes.

We responded to SERL on 27<sup>th</sup> September, stating that we were unable to provide assurance on the outcome of any claim, but that the approach they had set out with regard financing costs for their SoLR cost of capital claim did not appear unreasonable, as long as it was supported by a breakdown of those costs, and a justification for the approach taken.

SERL submitted a claim for the cost of working capital amounting to £2,227,225.36. It submitted evidence that detailed its expenditure relevant to its claim for working capital costs, as well as justification for why it had applied the interest rate that it had. Based upon our assessment of the submitted evidence against our overall criteria, which included reviewing commitments made when SERL was appointed as SoLR and comparing the rate against all other claims submitted to Ofgem on 7 October 2022, we stated in our minded-to letter that we were satisfied that SERL has provided adequate evidence to demonstrate the rate of interest they faced in respect of working capital costs is reasonable. We further stated that we believe that SERL'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 on the reasonableness of the rate applied by SERL applies in this case, and for this purpose only, and means that we may take a different view as to what is a reasonable rate, or approach to, financing for other purposes or in other cases.

### Resubmission of claim for working capital

In our minded-to letter we stated that working capital may only be claimed on costs that meet our criteria for assessing claims<sup>27</sup>. 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, the total amount of working capital claimed for of £2,227,225.36 was subject to SERL 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 required SERL to recalculate the working capital element of their claim using, as costs incurred, the amounts we stated we were minded-to consent to in our minded-to letter.

In our minded-to letter we also stated our expectation that SERL should follow the same methodology, and apply the same rate, as their 7<sup>th</sup> October submission, and to clearly set out which costs have been reduced or removed. We also asked that SERL submit their full calculations to allow us to undertake these calculations on working capital unilaterally for our decision, so that we could work out what their working capital allowance should be, without having to revert to SERL.

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<sup>27</sup> <sup>27</sup> <https://www.ofgem.gov.uk/sites/default/files/2022-11/SOLR%20Levy%20-%20Minded%20to%20position%20for%20consultation%20-%20Shell%20-%20GoTo.pdf>



However, following the submission of the requested information from SERL, we were unable to carry this out using the model provided to us by SERL, as the model SERL had employed was unsuitable for us to carry out adjustments unilaterally. Following bilateral engagement with SERL to understand why we could not make unilateral adjustments as requested in the model that they had submitted, it was confirmed that this was not possible for the model that SERL had used. We asked SERL to submit in a format (ideally the version that we had provided in template form for the consultation) that would allow us to undertake these adjustments, and that we would consider as part of our decision which model to use. This is discussed further in the 'Summary of Responses' section, below.

### Summary of consultation responses

SERL noted in their response to our minded-to letter that they recognise the need to recalculate cost of capital based on deductions made to other cost categories and that they had provided a model enabling this to be done by Ofgem.

As noted above, with the model SERL provided to us on 18<sup>th</sup> November 2022, we were unable to carry out the required adjustments to the cost inputs unilaterally. We met with SERL on 7<sup>th</sup> December 2022, and it was agreed that they would provide representations to us on why they consider the approach they had taken to be reasonable and in line with our requirements, as well as an updated model, which could be unilaterally amended by us, in line with the requirements set out in our minded-to letter. These were received on 9<sup>th</sup> December 2022.

In their letter dated 8<sup>th</sup> December 2022, SERL made the following representations:

- that the approach taken in their October submission is reasonable and meets the requirements of the claim
- that the underlying approach was seemingly accepted by Ofgem in the minded-to letter
- that the approach represents SERL's underlying financing and planning approach
- that the approach enables changes to the minded-to approach to be input
- that they do not consider the impact of changes to specific cost categories which may take the minded-to cost of capital amounts higher or lower is the key question for current purposes
- that they Ofgem approach would leave out the inherent working capital cost of running an additional customer book.

Our response to the representations made by SERL, and our assessment of the accompanying, updated, model is discussed in the 'decision' section, below.

### Reasons for decision:

We consider that the rate at which working capital has been calculated by SERL is consistent with our criteria and reasonable in these cases and for this SoLR claim only. Our decision is on the reasonableness of the rate applied by SERL in this case, and for this purpose only, and means that we may take a different view as to what is reasonable rates, or approach to, financing for other purposes or in other cases.

However, we have not yet been able to form a view on whether the approach taken by SERL in calculating their working capital claim is consistent with our criteria. This is because we have been unable to verify that the costs included in the working capital claim, and the approach taken to calculating working capital based on these costs, is consistent with the requirement that working capital may only be claimed on costs to which we have consented.

As discussed above, it was agreed in discussions with SERL that they would provide an updated model that would allow us to make changes to the input amounts in line with the amounts stated in our minded-to letter that we were minded-to consent to. It was also agreed that SERL would submit representations on the approach to working capital they had taken.

As stated in our minded-to letter, working capital may only be claimed on costs that we have decided meet our criteria for assessing claims and so to which we have consented. We have been unable to verify that only such costs were included in the model used to calculate the working capital claim. SERL made representations that the approach taken by Ofgem does not cover the inherent working capital costs of running an additional customer book or other factors such as delays in receiving payments from customers. Our position is that working capital costs may only be claimed on costs that meet our criteria for assessing claims. While the approach taken by SERL may reflect SERL's own internal financial and planning approach, we are not yet clear that this is aligned with our criteria.

The updated model provided to us on 9<sup>th</sup> December 2022 was based on the SERL claim submitted on 7<sup>th</sup> October 2022, but differed in the approach taken to calculating working capital, and was similar to the approach Ofgem had set out in the templates provided to suppliers. However, SERL did not make the deductions we had requested in our minded-to letter, but instead provided a model which would allow us to make the deductions unilaterally, which required significant resource for us to carry out. When this was undertaken it resulted in an increase to the claim for working capital, not a decrease as would be reasonably expected as a result of decreasing the total value on which working capital could be claimed for. Given that, we need to do further verification and assessment of the different models which have been used to understand them and make a final decision on what the appropriate approach to calculation may be.

At this time we are unable to reach a final decision on the calculation for the deduction for the working capital element of SERL's claim for GoTo. As such, for the purposes of determining a value of the claim allowable for working capital for this payment period, and noting that we do not have concerns with the working capital rate proposed by SERL, we have decided to allow the figure of £2,227,225.36 provided in their original submission, noting that our intention will be to undertake a review of the working capital calculation in the new year, and that we expect to make our final decision on the value of working capital to be allowed to SERL in relation to acting as SoLR for GoTo next year. Our future final decision on the value of working capital to be allowed will also be subject to the further calculations we intend to conduct in 2023 in relation to incremental hedging costs and unexpected demand, which – as described above – may require SERL to provide further evidence and/or clarification of existing evidence.

Our decision is to provisionally consent to SERL's claim of £2,227,225.36 for working capital costs incurred in acting as SoLR for GoTo. However, this does not represent

agreement with the approach taken by SERL for the calculation of their working capital claim, and we will continue to work through this.

### **Cost category: "Other costs"**

We understand that other costs may have been incurred when undertaking activities as part of becoming a SOLR (for example, legal fees). We have used the criteria set out in our published policy decision to assess whether these costs are appropriate and should be recovered through a LRSP. The other costs that SERL has claimed are detailed below.

SERL claimed £197,581.50 in other costs incurred as a result of complying with the Last Resort Supply Direction. We consider that the claimed amount is not consistent with our criteria.

We have consented to SERL claiming a up to £37,166,73, which we consider to be a more accurate calculation of the amount of other costs to be paid as part of a LRSP claim.

In their SoLR RFI, SERL committed to contributing £4m against their overall claim for other costs for Colorado, Pure Planet, Daligas and GoTo. This has been deducted from the overall figures contained within the claim prior to publication.

*Table 5: Summary of claims and decision for other costs*

<b>Item</b>	<b>Cost</b>	<b>Initial Claim</b>	<b>This claim</b>	<b>Minded-to deductions</b>	<b>Decision on deductions</b>	<b>Decision on this claim</b>
4	Other costs <ul style="list-style-type: none"> <li>Legal, finance contracting, customer service, IT licence, Debt Collection Agency, REGOs</li> </ul>	£0.00	£197,581.50	£160,414.77	£160,414.77	£37,166.73

### **Legal costs**

#### Summary of minded-to position

SERL requested our consent to claim for a LRSP for legal costs incurred when acting as a SoLR for customers of GoTo. SERL engaged legal resources to support them acting as the SoLR for five failed suppliers concurrently. We were minded to allow these costs as we agreed in principle that they met our criteria, but we were not fully satisfied as the legal costs were not attributed to an individual supplier. Our position was conditional on SERL being able to provide further detail on how the costs were attributed to each claim.

### Summary of consultation responses

SERL engaged in bilateral meetings with Ofgem throughout the consultation period, and submitted additional evidence for Ofgem to consider throughout the consultation period. As part of this information, SERL provided additional evidence and explanatory narrative as to why these costs meet our criteria. Initially, SERL were not able to apportion the legal costs to each of the failed suppliers as work was carried out to cover all the failed suppliers simultaneously.

Following bilateral meetings with SERL, it was agreed that in this circumstance, the best approach would be for SERL to apportion the costs equally across the relevant failed suppliers, as the evidence pertained equally to the situations in question. SERL subsequently submitted the reapportioned amount and set out the rationale for the apportionment.

We did not receive any written consultation responses referencing SERL's request to claim for a LRSP for legal costs incurred as a result of migrating former customers of GoTo to SERL.

### Rationale for decision

Having considered the evidence submitted by SERL through the consultation period, and the explanation provided through bilateral meetings regarding the apportionment rationale in this circumstance, we are satisfied that the evidence supplied supports the claim and that the costs have been directly incurred by SERL acting as a SoLR, are 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 SERL to recover these costs and we have approved the full amount claimed.

## **Finance Contracting costs**

### Summary of minded-to position

SERL requested our consent to a claim for LRSP for finance contracting costs incurred as a result of migrating former customers of GoTo to SERL. This short-term additional resourcing was to ensure that credit balances were returned to the appropriate SoLR customers as there was a large increase in the volume of credit balances and incoming payments associated with SoLRs. SERL submitted evidence which demonstrated that these costs had been incurred. However, in our minded-to position, we stated we were not fully satisfied that the evidence showed that these costs were additional and economic. We were minded to approve the cost provided that SERL gave further evidence to demonstrate that these costs were additional to those SERL would have incurred if these customers were acquired through normal customer acquisition routes.

### Summary of consultation responses

SERL engaged with us through the consultation period and have submitted additional evidence to support their claim along with an explanatory narrative as to why these costs meet our criteria and are a direct result of acting as a SoLR in an emergency situation.

We did not receive any responses referencing SERL's request to claim for finance contracting costs incurred as a result of migrating former customers of GoTo to SERL.

### Rationale for decision

Having reviewed the additional evidence submitted by SERL, we are satisfied that these costs are additional, directly incurred as part of the SoLR role, otherwise unrecoverable, unavoidable, and efficient in relation to SERL acting as a SoLR for former customers of GoTo. 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 SERL to recover these costs and we have approved the full amount claimed.

## **Customer service costs**

### Summary of minded-to position

SERL requested our consent to a claim for LRSP for customer service costs incurred when acting as a SoLR for customers of GoTo. SERL incurred these costs as they contracted with a third party to send communications to SoLR customers to keep them informed of their transition from GoTo to SERL. We were minded to approve these costs as SERL had provided supporting evidence, which included detailed invoices of direct costs incurred through SoLR activity and narrative explanations of the reasons for choosing the third-party. We were satisfied that the costs incurred meet our criteria.

### Summary of consultation responses

We received no consultation responses referencing SERL's request to claim for customer service costs incurred when acting as a SoLR for customer of GoTo.

### Rationale for decision

We are satisfied that these costs have been incurred as a direct result of SERL acting as a SoLR for former customers of GoTo, are additional to what SERL would have faced in the course of normal retail operations, and that SERL have made reasonable efforts to minimise the costs. 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 SERL to recover these costs and we have approved the full amount claimed.

## **IT Licence costs**

### Summary of minded-to position

SERL requested our consent to claim for a LRSP for costs incurred for IT licences acquired when acting as a SoLR for customers of GoTo. SERL provided invoices to support the claim and demonstrate that the costs have been incurred. In our minded-to position we stated that we were minded-to consent to the claim as these are the types of costs we consider would likely meet our criteria. However, as it was not clear what the licences related to, we needed additional evidence to satisfy us that this element of the claim meets our criteria that the costs incurred are additional and economic.

### Summary of consultation responses

SERL engaged in bilateral meetings with Ofgem throughout the consultation period, and submitted additional evidence for Ofgem to consider throughout the consultation period. As part of this information, SERL provided additional explanatory narrative that the licence costs for software used through the SoLR process were additional and a direct result of acting as a SoLR in an emergency situation, and explained what these licences were needed for as part of the bilateral engagement.

SERL responded to this element of the claim in their consultation response, confirming their view that this cost was additionally evidenced to completeness through the information that they had provided through the consultation period. We did not receive any further consultation responses referencing SERL's request to claim for a LRSP for IT licence costs incurred as a result of migrating former customers of GoTo to SERL.

#### Rationale for decision

SERL provided additional explanatory narrative that the licence costs for software used through the SoLR process are additional and a direct result of acting as a SoLR in an emergency situation. Having considered the evidence submitted by SERL through the consultation period, and the explanations provided through bilateral meetings, we are satisfied with the additional information provided by SERL that these costs are as a direct result of acting as a SoLR for GoTo and are additional and economic. 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 SERL to recover these costs and we have approved the full amount claimed.

### **Debt Collection Agency Costs**

#### Summary of minded-to position

SERL requested our consent to claim a LRSP for costs incurred as a result of contracting with a third-party debt collection agency as part of the process of onboarding former customers of GoTo. SERL provided evidence including detailed invoices and narrative explanations of the reasons for choosing the third-party. In our minded-to position, we were satisfied that the evidence provided by SERL met our criteria that these costs are otherwise unrecoverable, and that SERL put processes in place to minimise the costs to consumers. Furthermore, in our minded-to position we thought that these costs were as a direct result of SERL acting in its role as SoLR for former customers of GoTo and are additional to those it would have faced in the course of normal retail operations. We considered that the costs incurred were reasonable within the circumstances of this case and we were minded to consent to this portion of the claim.

#### Summary of consultation responses

We received one consultation response from another supplier regarding SERL's request to claim for debt collection agency costs for GoTo.

The respondent disagreed with our minded-to position to approve the full amount claimed by SERL for costs incurred in contracting a third-party debt collection agency. Otherwise, they expressed their expectation that Ofgem should provide more detailed reasoning as to why such costs can be justified as part of a LRSP claim. The respondent's view was that this was a commercial decision for SERL to purchase the debts of GoTo's former customers and that it was not part of the SERL's SoLR duties.

#### Rationale for decision

We have considered the consultation response expressing the view that these costs were incurred as the result of a business decision by SERL and, therefore, were avoidable. SERL have submitted evidence, including an explanation as to why these costs were unavoidable. After considering the information provided, we are satisfied that these costs were incurred for SoLR related customer activities and that actions were taken through customer communications to minimise these costs. Due to constrained internal

resourcing, a third-party debt collection agency was contracted to address actions as a result of taking on SoLR customers. The evidence was thoroughly assessed, as we have done with all parts of all claims, and we have an assurance process in place.

We acknowledge that the supplier who responded on this aspect of the claim requested more transparency. We consider that providing more granular detail on SERL's, or other suppliers' claims for these types of costs, other than what we have set out above, would raise commercial confidentiality concerns amongst suppliers.

In our assessment of all the evidence provided, SERL have demonstrated how these costs were unavoidable, economic, otherwise unrecoverable, and directly related to SERL acting in its role of SoLR for former customers of GoTo. 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 SERL to recover these costs and we have approved the full amount claimed.

## **Renewable Energy Guarantees of Origin costs**

### Summary of minded-to position

SERL requested our consent to claim a LRSP for the cost of purchasing Renewable Energy Guarantees of Origin (REGOs) as part of taking on former customers of GoTo. In their submission to us, SERL argued that in order to maintain the SERL and GoTo customer proposition of renewable power for all customers, so as not to discriminate against and misrepresent its product offering to SoLR customers, additional REGOs for SoLR customers are required. In our minded-to position, we did not consent to this element of SERL's claim. We considered that this cost does not meet the criteria of being directly incurred as part of SERL's SoLR role and unavoidable. As SERL was under no obligation to purchase the additional REGOs, we consider that the cost was incurred in relation to a business decision by SERL to maintain renewable energy credentials.

### Summary of consultation responses

We received two consultation responses with regard to SERL's claim for REGOs. One from SERL and one from another supplier.

In their consultation response SERL did not agree with our view that purchase of the additional REGOs for customers acquired through the SoLR process was a solely commercial decision. SERL highlighted that they offer renewable electricity as standard on all their tariffs. To maintain this approach, which is part of their brand proposition and marketing, additional REGOs were required for SoLR customers. In addition, SERL highlighted that not purchasing REGOs for SoLR customers would have adversely affected their renewable status under their Fuel Mix Disclosure. However, they did note that an alternative would have been to create a specific tariff for SoLR customers which made clear that '*representations made as to renewable electricity as standard for all tariffs did not in fact apply to SoLR customers.*'

The other supplier who commented on the minded-to position agreed with our decision to disallow SERL's claim for REGO costs. They noted that doing so would send out a strong message to all future SoLRs that claims should not do anything to undermine confidence in the SoLR levy claim process, which they feel SERL's claim for REGOs has done. They further commented that suppliers should recognise the fact that any payment from the levy is ultimately consumers' money and should be responsible when claiming for costs through the levy.



### Rationale for decision

After considering the consultation responses, we are satisfied that this cost does not meet the criteria of being directly incurred as part of SERL's SoLR role and unavoidable. SERL was under no obligation to purchase the additional REGOs and could have offered an alternative tariff to the customers acquired through the SoLR process. We consider that the cost was incurred in relation to a business decision by SERL to maintain renewable energy credentials, as the purpose of the certificate is to prove to the final customer that a given share of energy was produced from renewable sources, not that it changes the fuel mix purchased on behalf of the consumer.<sup>3</sup> In the particular circumstances of this case we do not consider that it would be reasonable, taking into consideration consumer interests, to allow SERL to recover these costs through the LRSP.

### **Recovery of LRSP claim**

SERL 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**