

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

Email: solrlevyteam@ofgem.gov.uk

20 October 2023

Dear Colleague

Last Resort Supply Payment Claim from Shell Energy Retail Limited

On 7 September 2023, Shell Energy Retail Limited ("SERL") gave notice to Ofgem of its claim for a Last Resort Supply Payment (LRSP) in relation to acting as Supplier of Last Resort (SoLR) to customers of the former Daligas Limited ("Daligas").

Under Standard Licence Condition (SLC) 9.1 of the Supply Licence, SoLRs are entitled, provided Ofgem consents, to make a claim for a LRSP from each Relevant Gas Transporter and Electricity Distribution Operator. The claim from SERL included its calculation of the claim amount and information to support the calculation (outlined in Table 1).

This letter sets out the reasons why we are minded-to recover an overpayment from SERL of **£263,303.32** in relation to this claim.

We are minded-to recover the overpayment of costs incurred in complying with a Last Resort Supply Direction¹ relating to:

- Additional wholesale costs incurred as a result of commitments to supply energy to SoLR customers; and
- financing costs incurred on becoming a SOLR.

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 volatile 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. Our policy on assessing further claims under this temporary multiple-claim process was published on 21 September 2022². On 25 May 2023 we published a further consultation on whether to end or continue the temporary multiple-claim process. In the consultation decision, published on 24 August 2023, we set out our decision to maintain the temporary process until at least

¹ [Direction to appoint Shell Energy Retail Limited as Gas Supplier of Last Resort to Daligas Limited | Ofgem](#)

² <https://www.ofgem.gov.uk/sites/default/files/2022-09/Decision%20on%20the%20last%20resort%20levy%20claims%20true-up%20process.pdf>

after winter 2023/24, at which point we would again review market conditions and consult on whether the temporary process should be ended.³

As part of that faster multiple-claim levy process, each of the SoLRs entered into a True-up Agreement with Ofgem. Under the True-up Agreement between SERL and Ofgem, Subsequent Levy Claims and a final True-up claim may be made following the Initial Levy Claim. Clause 5 of the True-up Agreements sets out what is required for a final True-up claim.

Clause 2.2 of the True-up Agreements sets out that the agreement will terminate on the earlier of the following:

- (a) Where any Valid True-up Amount is an Excess, the date upon which the SoLR has repaid in full the total of any Excess resulting from the True-ups of all Last Resort Supply Directions covered by this Deed;*
- (b) Where any Valid True-up Amount is a Deficit, the date of the last of the Valid Final Levy Claim(s) covered by this Deed; and*
- (c) The date of termination specified in any notice of termination of this Deed issued by the Authority.”*

Following our assessment of this current claim, we consider that it meets the requirements of a True-up claim under clause 5 of the True-up Agreement. We propose to treat it as a True-up under the True-up Agreement. This means that the True-up Agreement will cease to have effect when the SoLR has repaid the total of any Excess in our final decision.

The True-up Agreements that SoLRs entered into with Ofgem address the possibility that a SoLR may have received overpayments (an Excess). Clause 7 of the True-Up Agreement provides:

*7.1 Where any Valid True-up Amount is an Excess, the Authority shall, acting reasonably, determine that the SoLR must repay an amount equal to the Excess including any interest accrued. Where it so determines and acting reasonably, the Authority shall provide a draft direction setting out the time, method and amount of any such repayment, together with the rate of interest, where relevant, and shall provide such draft to the SoLR and other relevant stakeholders, consulting where appropriate (a **Draft Repayment Direction**).*

*7.2 The Authority will consider any representations received from the SoLR, and, if relevant, any consultation on the Draft Repayment Direction and will issue a final repayment direction setting out the time, method and amount that the SoLR will be required to repay, including any interest (a **Final Repayment Direction**).*

Ofgem is minded-to issue a Draft Repayment Direction in accordance with clause 7 of the True-up Agreement following a decision on SERL’s final true-up. We are minded-to require that the method of repayment be through SERL making payments to the relevant Gas Distribution Networks (GDNs) and the relevant District Network Operators (DNOs), which would then be passed through to all energy customers in the form of adjusted charges.

The purpose of this consultation letter is to provide interested parties with an opportunity to make any representations to us, ahead of us making our final decision. We will take such representations into account in our final decision making and may make

³ [Decision on ending the temporary Last Resort Supply Payment claim process | Ofgem](#)

changes to our minded-to position in response to such representations, if we consider it appropriate to do so.

In addition, before we make our final decision we will conduct an additional assurance process in respect of the calculations contained in our minded-to position, the results of which may also be reflected in our final decision.

We expect to make our final decision in mid-December 2023.

Background

The SoLR process

Electricity and gas supply is a competitive activity in Great Britain. While competition has the potential to bring many benefits to consumers, in a competitive market, companies that are not operating efficiently may fail. This applies as much in relation to the gas and electricity supply markets as it does to other markets.

It is Ofgem's statutory duty to protect customers' interests when suppliers fail. When a supplier fails, our focus is to ensure continuity of supply for its customers and to minimise wider negative impacts on the market.

Ofgem can ensure continuity of supply to the failed supplier's customers and minimise these wider negative effects by appointing a SoLR, which is issued with a Last Resort Supply Direction requiring it to supply the failed supplier's customers at very short notice⁴.

Failed Supplier event

On 17 October 2021 we appointed SERL as the SoLR⁵ for Daligas gas⁶ 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 Daligas as the SoLR to those customers in our decision letter published on 23 June 2022⁷.

Claim for Last Resort Supply Payment

Under SLC 9.1 of the Supply Licence, SoLRs are entitled, with Ofgem's consent, to make a claim for a LRSP from each Relevant Gas Transporter and Electricity Distribution Operator.

SLC 9.4 provides that the total amount of the LRSP must not exceed the amount by which the total costs (including interest on working capital) reasonably incurred by the SoLR in supplying customers under the Last Resort Supply Direction and a reasonable profit plus any sums paid or debts assumed by the SoLR to compensate customers in respect of any customer credit balances plus any additional (actual or anticipated) interest and finance

⁴ The obligation for a supplier to comply with a LRSD derives from standard licence condition 8 of each supplier's gas and electricity supply licences and is intended to ensure a universal service for Great British energy consumers (for further information on this universal service, see Articles 3(3) of the EU Directives 2009/72/EC and 2009/73/EC).

⁵ Link: [Ofgem appoints Shell Energy Retail Limited to take on customers of Pure Planet Limited, Daligas Limited and Colorado Energy Limited | Ofgem](#)

⁶ Link: [Direction to appoint Shell Energy Retail Limited as Gas Supplier of Last Resort to Daligas Limited | Ofgem](#)

⁷ Link: [Appointment of Shell Energy Retail Limited as Supplier of Last Resort for Daligas Limited | Ofgem](#)

costs associated with a financing arrangement approved under SLC 9.7C are greater than the total amounts recovered by the SoLR through charges for that supply.

SLC 9.6 makes clear that Ofgem may determine that an amount other than the one calculated by the SoLR is a more accurate calculation of the relevant amount and, in such cases, the amount specified by Ofgem must be treated as the relevant amount when the licensee submits its claim to each relevant electricity or gas network licensee in accordance with SLC 9.8.

LRSPs are paid for by the relevant gas and electricity network operators, who then recover the cost through charges to suppliers. SLC 38B of the Electricity Distribution Licence and Standard Special Condition A48 of the Gas Transportation Licence set out the details of this.

Our true-up decision process and methodology

During winter 2021/22 we introduced a number of changes to the process for making LRSP claims, which were designed to ensure that the SoLR process continues to protect consumers in the current market conditions. The changes included the temporary introduction of a faster, multiple-claims process whereby SoLRs are able to submit more than one claim in relation to each Last Resort Supply Direction.

This involves SoLRs submitting an 'initial claim' for costs faced in serving SoLR customers (typically wholesale commodity costs) in the period immediately after appointment. These initial claims were therefore limited to the recovery of costs for energy delivered within 6 months of their SoLR appointment or up to the end of March 2022, whichever was earlier. SoLRs may then follow this claim with an additional claim (or claims) in accordance with SLC 9. We refer to these additional claims as either a Subsequent claim or a final True-up claim. SoLRs entered into a 'True-up Agreement' with Ofgem to support the faster process. The Initial, Subsequent and True-up claim consents are conditional on SoLRs meeting the requirements of the True-up Agreement. The true-up process is intended to reconcile suppliers' initial and subsequent claims with actual costs incurred and determine any additional payments or repayments that should be made.

Following consultation, on 21 September 2022⁸ we published our policy decisions on our approach to these true-up claims. These policies have been applied in order to reach our position on subsequent and true-up claims.

In December 2022, Ofgem consented to SoLRs making Subsequent levy claims totalling £405m on the condition that these claims be treated as Subsequent levy claims under the True-up Agreements, and that the Agreements remain in place until a valid final True-up claim is made. As a result, SoLRs that submitted claims in 2022 under their True-up Agreements were still required to submit to Ofgem a final True-up claim for each Last Resort Supply Direction in respect of which they have a True-up Agreement.

In May 2023, we set out in an open letter our expectations for SoLRs' final True-up claims following the LRSP claims that were approved in December 2022 under the temporary multiple claim process.⁹

⁸ <https://www.ofgem.gov.uk/sites/default/files/2022-09/Decision%20on%20the%20last%20resort%20levy%20claims%20true-up%20process.pdf>

⁹ [Update on the last resort claim process for 2023 | Ofgem](#)

Under Supplier 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 SLC 9.3.

Our process to reach our minded-to position included:

- a. A quantitative check of SERL's 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 or subsequent claim made by the SoLR;
 - c. Undertaking validation of some assumptions with other data sources, where appropriate; and
 - d. A qualitative and quantitative assessment of the claim for costs related to wholesale and working capital in accordance with the relevant licence conditions and/or 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.

SERL claim

SERL indicated at the time of our SoLR appointment process that it would not waive its right to make a claim for LRSP for wholesale, credit balances and working capital costs, save where SERL made and subsequently honoured specific commitments to bear a proportion of costs themselves.

The initial claim was consented to on 17 December 2021,¹⁰ and a subsequent claim was consented to on 20 December 2022.¹¹ Consistent with the terms of that consent and the True-up Agreement between the SoLR and Ofgem, we have taken those claims into consideration in reaching our minded-to position on this claim.

¹⁰ Our Notice of Reasons for granting consent to the initial claim was published on 23 June 2022: [Faster SoLR levy process: Notice of Reasons for Last Resort Supply Payment \(LRSP\) claims | Ofgem](#)

¹¹ [Decision on last resort levy true-up claims | Ofgem](#)

Summary of our minded-to decision

Based on the information available and consideration of the circumstances in which the claims for LSRPs by SERL were consented to, and in accordance with the True-up Agreement in relation to customers of the former Daligas, Ofgem is minded-to recover an overpayment of £263,303.32.

Under the Supplier SLCs we are required to consider on a case-by-case basis whether in the circumstances it is appropriate for a SoLR to make a claim for a LRSP. We have set out below our reasons for our position for this case. This should not be taken as setting a precedent for any future claims, which would also be considered on their merits and on a case-by-case basis, taking into account all relevant circumstances of the particular case.

Table 1: Summary table of initial claim, true-up and minded-to position on final claim amounts.

Item	Cost	Initial Claim Approved	Subsequent Claim Approved	True-up Claim Submitted	Minded-to position on True-up Claim
1	Wholesale	£3,197,840.50	£486,435.44	£0	£30,979.02
2	Working Capital	£0	£472,213.58	£0	-£294,282.34
	Total				- £263,303.32

Reasons for our minded-to decision

Cost category: Wholesale

In our decision published in December 2022 on SERL's subsequent claim for Daligas we consented to £486,435.44 in wholesale costs, but due to the complexity of the claim we noted that we would need to undertake further analysis in a true-up claim in 2023.

Work undertaken since December 2022

Since the decision on SERL's subsequent claim, SERL has provided additional evidence. We have carried out further analysis of SERL's claim and engaged with SERL further on this matter. In this analysis, we considered adjustments to the amount of wholesale costs that SERL could claim by the following categories:

1. Initial Demand Forecast
2. Churn Adjustments
3. Misallocation of Customers
4. Combined Claim for Shipper Trades and Forward Trades

In addition, using the additional information we have received and analysed since the December 2022 we are minded-to adjust the amounts previously allowed for:

5. Backwardation Costs
6. CfD Costs

We are minded to make specified adjustments to true-up SERL's levy claim for Daligas.

Decision

Following the assessments described above, we are minded to consent to:

Table 2: Summary of claims and minded-to position for wholesale costs

Item	Cost	Initial Claim Approved	Subsequent Claim Approved	True Up Claim: Categories	Minded-to position on True-up Claim
1	Wholesale	£3,197,840.50	£486,435.44		
				Initial Demand Forecast	£30,477.77
				Backwardation	£501.24
Total:					£30,979.02

Initial Demand Forecast:

Our understanding is that, on average, over its SoLR portfolio, [REDACTED]

[REDACTED] purchases were made when wholesale prices were higher, which, if those additional costs were accepted would result in a higher than necessary cost to consumers.

Decision on this adjustment:

We are minded to consent to an additional £30,477.77 compared with the amount claimed to date for the effect of Initial Demand. This increase arises as a result of a change of methodology, in particular a change to the method by which we have re-valued trades

[REDACTED] (see methodology section below).

Methodology for this adjustment:

The volume of purchases SERL executed in the later window between [REDACTED] and [REDACTED] [REDACTED] has been estimated as the residual volume of all trades executed in that window after deducting modelled net purchase volumes for churn (see section on churn below) and for trades which were deemed to have been made for misallocation of customers (see relevant section below).

In our calculations, this residual volume has been disallowed, and instead added to the hedges executed prior to the window. This has been done by adding an equivalent volume to the earlier traded volumes while leaving prices unchanged. This differs slightly from the approach taken in the December 2022 decision, in which average prices through October were used as alternative prices.

The associated value deduction represents the difference between the claimed value of the residual volume and the value which would have been claimed had that volume been executed at prices achieved by SERL prior to the window.

In reaching our minded-to position we have taken into consideration the following points:

- Whether to account for a liquidity premium for the additional volume which is modelled as being purchased prior to the window. We consider that the appropriate level of such a premium would be extremely difficult to calculate, given that SERL would have had many options for the timing of its purchases, for example spreading purchases over one or more different days. We note that SERL's volume requirements are relatively low compared with daily liquidity. We are open to considering further evidence from SERL on this point, as part of this consultation process.
- Whether to adjust for peak and baseload prices. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]. We also consider that to account for peak prices would be to introduce a claim for shaping which would change the nature of SERL's claim and would need to be assessed against our published policy position in relation to shaping¹².

Churn Allowances:

SERL has claimed for the [REDACTED]
[REDACTED] This is the 'unexpected demand' or reduced 'churn' of customers away from SERL. The effect of this change would have been to increase the number of customers for which SERL needed to

¹² [Decision \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/decision)

buy energy for Q1 2022 delivery. SERL has not made an explicit claim for a specific amount for the impact of updating its churn assumptions.

[REDACTED]

We note that the changes in forecast customer numbers were not positive for all of the suppliers for whom SERL acted as SoLR. Where customer number changes were negative, we have offset these against the positive values allowed.

For Daligas we are minded to allow trades for churn of net claim value £78,260.40. This forms part of the overall claim; this does not represent an additional amount that we are minded-to award SERL as part of this decision.

Backwardation:

In February 2022 Ofgem introduced a retrospective allowance into the default tariff cap to allow suppliers to recover the systematic and unrecoverable backwardation cost for suppliers incurred in cap period seven, beyond the normal basis risk inherent in the cap. An amount of £8 per customer (at typical consumption) was included within the cap for the year starting 1 April 2022, applied via an increase to the additional wholesale risk allowance component of the cap. In August 2022 a further allowance of £6 per customer was introduced, to be recovered in the year from 1 October 2022.

These allowances would be recovered from all customers, SoLR and non-SoLR. Given this, we considered that the revenues collected by suppliers under this allowance should be deducted from claims made by SoLRs in relation to the costs of hedging SoLR customers' demand subsequent to it taking on the customers of the failed supplier. In other words, the costs of purchasing wholesale energy for these customers should be reduced because suppliers were allowed to recover approximately £14 per customer through higher bills in later periods.

We calculated the relevant deduction for each supplier in our decision in the subsequent claim (our December 2022 decision), 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 now have more detailed data from SERL for their customer numbers and demand forecast assumptions, and have revisited the calculations made for the December 2022 decision using the same methodology. For Daligas, this results in an additional allowance of £501.24 towards its claim.

General points made by SERL:

In reaching our minded-to position we have taken into consideration the following:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Cost category: Working capital

Our published policy decision on last resort levy claims True-up process¹³ sets out the requirements for SoLRs seeking to claim working capital costs.

Decision:

Ofgem consented to SERL claiming £472,213.58 for working capital costs in our 20 December 2022 decision on its claim for costs incurred in acting as SoLR for Daligas.¹⁴ In that decision, we said that we would work with SERL on a further decision to true-up working capital costs this year.

As part of its claim this year, SERL provided an adapted working capital model that allows us to review and quantify the deductions that have been made across the cost categories claimed, and to verify that these are accounted for in the working capital calculations.

We consider that the amount calculated using the adapted model is consistent with our criteria and we are minded-to recover £294,282.34 for working capital costs. Our rationale for this minded-to position is set out below.

Table 3: Summary of claims for working capital

Item	Cost	Initial Claim Approved	Subsequent Claim Approved	Adapted Model with 2023 Deductions	Minded-to position on True-up Claim
2	Working Capital	£0	£472,213.58	£177,931.24	-£294,282.34

Rationale for decision:

When a SoLR is appointed, it incurs costs associated with taking on the new customers and these costs need to be financed. There is a range of ways in which a SoLR can finance this activity. Regardless of the finance option used there is a cost in doing so. Under Supplier SLC 9.4(a) a SoLR may claim total costs reasonably incurred in supplying premises under the Last Resort Supply Direction, including the interest on working capital.

On 7 October 2022, SERL submitted a further levy claim as part of the temporary multiple claim process established in December 2021. This included a claim for the cost of working capital. As set out in our minded-to position in November 2022, we requested that SERL resubmit the working capital claim taking into account our minded-to deductions in the other cost categories, as we consider that working capital is only claimable through the levy in relation to costs that meet our overarching criteria for levy claims.¹⁵

¹³ [Decision on last resort levy claims true-up process | Ofgem](#)

¹⁴ [Decision on last resort levy true-up claims | Ofgem](#)

¹⁵ [Last resort levy true-up claim minded-to position | Ofgem](#)

Although an adapted model was submitted to Ofgem on 9 December 2022, which took a similar approach to the one Ofgem had set out in the templates provided to suppliers, we were unable to conclude our assessment of SERL's evidence in support of its claim for wholesale and working capital costs within the timeframe for consenting to the 2022 LRSP claims. As a result, for the purposes of determining a value allowable for working capital for a LRSP claim in that year, we decided to consent to a working capital claim of £472,213.58 for Daligas on 20 December 2022. However, our consent did not represent agreement with the approach taken by SERL for the calculation of their working capital claim, and we committed to continuing our assessment of the claim and engagement with SERL to reach an adapted working capital model, on which we have based this minded-to position.

In the adapted model submitted to Ofgem on 7 September 2023, the interest rate at which working capital costs have been calculated remained consistent with the previous claim. As in our decision in December 2022, we consider that this interest rate applied by SERL is consistent with our overarching criteria and reasonable in this case. Our decision is on the reasonableness of the rate applied by SERL in this case, and for this purpose only. We may take a different view as to what is a reasonable rate, or approach to financing for other purposes in other cases.

The adapted model has allowed us to unilaterally recalculate the working capital element of the claims, taking into account our minded-to changes to the allowable wholesale costs set out previously in this document.

We consider that the adapted model allows us to verify that only allowed costs are used in the calculation of the working capital cost element and that the interest rate has been applied appropriately. Our assessment of the adapted model has found that it aligns with the requirements set out in our September 2022 policy decision on working capital costs.

As a result of our reassessment of SERL's claim for Daligas, we are minded-to allow a total cost for working capital of £177,931.24. Taking into account our decision on this claim in December 2022 to allow £472,213.58, our minded-to position is a recovery of an overpayment of **£294,282.34**.

Requirements for final True-up claim

The True-up Agreements set out the requirements for final True-up claims, which provide that True-up claims must at a minimum contain certain things, including:

- a calculation with supporting evidence showing the total actual or committed additional costs incurred by the SoLR in complying with that Last Resort Supply Direction, including those costs already claimed for under the Valid Initial Levy Claim(s) and any Valid Subsequent Levy Claim(s) and showing whether those costs exceed or are less than the LRSP claims already made; and
- evidence for additional LRSPs not already claimed; and
- indication of any changes to circumstances relevant to previously approved claims, including changes to assumptions about wholesale costs; and
- evidence that all costs have been audited with due rigour and signed off by the company secretary or a director of the SoLR; and
- a declaration from the SoLR's board of directors or the financial director, where authorised by the SoLR's board of directors, that the information provided in the True-up is true, accurate and not misleading in any material respect.

In compliance with our published policy¹⁶ SERL undertook an independent internal audit to assess the accuracy of the true-up claims.

We are content that the claim meets all the requirements under the True-up Agreement for a final True-up claim, and that the internal audit and declaration provides sufficient assurance of the accuracy of the information provided to us to support SERL's claim.

We propose to treat this claim as a Valid Final Levy Claim so that the True-up Agreement will cease to have effect when the SoLR has repaid the total of any Excess in our final decision.

Next steps

The purpose of this letter is to provide the SoLR and interested parties with an opportunity to make any representations to us, ahead of us making our final decision on this LRSP claim. We invite any representations by 17 November 2023. Responses should be emailed¹⁷ to solrlevyteam@ofgem.gov.uk.

We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so that they can be placed easily on our website.

We will take into account all relevant information, including any representations we receive, and the results of our internal assurance of our assessment process in reaching our final decision on SERL's claim. We expect to make our final decision in mid-December 2023.

Yours faithfully,

Rohan Churm
Director, Financial Resilience and Controls

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

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