

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

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Dear colleague,

Last Resort Supply Payment claims from Shell Energy Retail Limited

On 30 August 2019, Shell Energy Retail Limited ("Shell Energy") gave notice to Ofgem of their intention to submit a claim for a Last Resort Supply Payment ("LRSP"). Shell Energy is seeking to claim for costs incurred in acting as a Supplier of Last Resort ("SoLR") to customers of the former Usio Energy Supply Limited ('Usio').

As per Supply Licence Condition 9, a SoLR may make a claim for a LRSP from relevant distribution networks where we have given our consent to the amount claimed¹. This letter sets out that we are minded to consent to a claim from Shell Energy for an LRSP of up to £354k².

The purpose of this consultation letter is to provide interested parties with an opportunity to make any representations to us, ahead of making our final decision. We currently expect to make our final decision in January 2020, in time to enable the agreed amount to be recovered from relevant gas and electricity distribution network companies in 2020/21³.

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 in light of supplier failure. When a supplier fails, our focus is to ensure continuity of supply for its customers and to minimise wider negative impacts on the market. These wider effects stem from the fact that if an energy supplier fails, its customers will continue to be physically supplied with gas and / or electricity, but the supplier will not be able to meet the costs of providing this energy. In these circumstances, the costs of procuring the necessary electricity will be smeared across all suppliers and the costs of procuring gas will fall to the relevant shipper.

¹ In accordance with Standard Condition 9 of the electricity and gas supply licences.

² Exactly £354,147.

³ We currently expect to take a decision in January 2020 in time for relevant Gas Distribution Network (GDN) companies to make payment of the relevant share of the LRSP claim in charging year 2020/21. Relevant Electricity Distribution Network Operators (DNOs) are required to begin payment no later than 3 months after being presented with a valid LRSP claim and to complete payment within a further period of 12 months.

There is also a real risk that if a supplier fails without urgent intervention, consumer trust and confidence in the energy market could be materially damaged.

Ofgem can ensure continuity of supply to the failed supplier's customers and minimise these wider negative effects by appointing a SoLR to supply the failed supplier's customers at very short notice.⁴

Usio Limited SoLR event

In October 2018, Usio confirmed to us that it was in severe financial difficulties, at which point we prepared to commence the SoLR process, to ensure consumers were protected. Following our standard process and published SoLR guidance we announced our decision to appoint First Utility (now Shell Energy)⁵ as the SoLR for Usio's gas and electricity customers on 18 October 2018⁶. This followed a competitive process aimed at getting the best deal for consumers, in line with our principal objective to protect the interests of existing and future consumers and our published guidance.

Of the submissions we received from suppliers, the majority confirmed they would honour the credit balances for Usio's customers. Given the implications for overall consumer confidence, as noted above, we also considered whether suppliers would honour the credit balances of former Usio customers who had switched away but were still due a credit refund. A number of suppliers – including Shell Energy – confirmed they would also honour these credit refunds. We outlined the material factors behind our decision to appoint Shell Energy as the SoLR in our decision letter published on 07 December 2018⁷.

Claim for Last Resort Supply Payment

As set out in the gas and electricity supply standard licence conditions, a supplier may make a claim for any additional costs it incurs in complying with a Last Resort Supply Direction (LRSD)⁸.

As part of their competitive bid to become a SoLR, a supplier will include whether they expect to make a claim for a LRSP, or whether it will waive this right, in whole or in part. As stated in our revised guidance, our preference is for the SoLR not to make any claim, and we expect efficient SoLRs to be able to minimise their exposure to otherwise unrecoverable costs to reduce the costs smeared across the rest of the market through a LRSP.

In our published guidance⁹, we explain that we will decide on a case-by-case basis whether it might be appropriate for a SoLR to make a claim under these arrangements. We also explain that we would consider whether the amount of any claim or the reasons for any claim were reasonable. In that guidance, we note that, in certain circumstances, we may consider it appropriate to approve a claim where it relates to costs associated with the protection of customers who held a credit balance with the failed supplier.

Shell Energy indicated at the time of the SoLR appointment process that it would not waive its right to make a claim and would claim for the recovery of a percentage of credit balances. In keeping with that commitment Shell Energy's claim is for the cost of credit

⁴ The obligation for a supplier to comply with a LRSD derives from standard licence condition 9 of each suppliers' 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). The duties of a SoLR are further described in our Guidance and the LRSD contains specific details of Shell Energy obligations to supply Usio Energy Supply Limited's former customers.

⁵ First Utility was appointed by Ofgem as the SoLR supplier for Usio's gas and electricity customers on 18 October 2018. First Utility was acquired by Shell in February 2018 and rebranded as Shell Energy Retail Limited on 25 March 2019.

⁶ https://www.ofgem.gov.uk/system/files/docs/2018/10/last_resort_supply_direction_electricity.pdf and https://www.ofgem.gov.uk/system/files/docs/2018/10/last_resort_supply_direction_gas_002.pdf

⁷ <https://www.ofgem.gov.uk/publications-and-updates/appointment-first-utility-supplier-last-resort>

⁸ Standard condition 9 of the electricity and gas supply licences

⁹ <https://www.ofgem.gov.uk/publications-and-updates/supplier-last-resort-revised-guidance-2016>

balances owed to customers of Usio when the company ceased trading. Shell Energy has indicated that the cost of credit balances for which it is claiming are final and based on actual meter reads.

Table 1: Shell Energy LRSP claim summary

Cost Category associated with SoLR	Cost claimed (£)
Recovery of 46% of net customer credit balances	354,147

Our decision process and methodology

Our process to reach our minded-to position consisted of:

- A quantitative check of the methodology for each cost item claimed. This includes determining how each total cost item was calculated based on data sent to us.
- Ensuring costs are in line with commitments made at the time of the SoLR appointment.
- Validation of assumptions with other data sources, where appropriate.
- A qualitative assessment of each claim item against our methodology criteria.

Our methodology criteria for SoLR levy claims are as follows:

- **Additional:** whether the costs claimed are additional to the costs to the SoLR of serving 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. Although the SoLR is generally expected to know or predict the costs they will incur in serving a new customer base and take these into account in their competitive bid, there may be cases where this is not possible.
- **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. It would not be appropriate for us to allow the SoLR to claim for costs they would have incurred through a normal acquisition route.
- **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 through the administration process or customer charges, for example.
- **Unavoidable:** whether the SoLR had made all reasonable efforts to avoid the cost in the first instance or absorb the cost.
- **Efficient:** whether the SoLR has taken all reasonable steps to reduce the magnitude of any unavoidable and unrecoverable costs incurred, and therefore the total amount claimed.

LRSP claim

Shell Energy's claim of £354,147 is for the cost of refunding credit balances owed to customers of Usio when the company ceased trading. Shell Energy is not claiming for the cost of 'closed' credit balances owed to former customers of Usio who had switched to another supplier at the point the company ceased trading. The LRSP claim is net of a contribution by Shell Energy to credit balances.

Table 2: Shell Energy LRSP claim breakdown

Claim element	Cost claimed (£)
Open customer credit balances	769,037
Less Shell Energy contribution	-414,890
LRSP claim	354,147

Shell Energy has indicated that it incurred a number of other costs in relation to its role as the SoLR which it not claiming for. These costs, which are not final, relate to third party contracts, customer call and contact handling.

Our minded-to decision

On balance, taking into consideration all information available to us and the specific circumstances of this case, we are minded to consent to Shell Energy claiming a Last Resort Supply Payment of up to £354k¹⁰. We are minded to make this decision in light of the broader market considerations and our wider statutory duties to protect both existing and future consumers.

Our position would enable Shell Energy to recover up to this amount from relevant distribution network licensees in 2020/21. This is subject to any costs recovered from the Usio liquidation process.

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

Reasons for our minded-to decision

Our published guidance states that we may in certain circumstances approve a claim associated with costs incurred in repaying credit balances to customers who had a positive credit balance with a failed supplier. We are satisfied in this case that the claimed amount is consistent with the relevant criteria and consistent with the commitments made by Shell Energy to claim only for the cost of credit balances and to make a financial contribution to offset the cost of credit balances.

We have considered whether the costs Shell Energy is seeking to claim for credit balances are otherwise unrecoverable. It may still be the case that Shell Energy is able to recover some of this claimed amount through the ongoing administration process for Usio. The current licence provisions related to LRSPs do not require us to make our decision on Shell Energy's claim ahead of the conclusion of the liquidation process.

However, in our view delaying a decision until the conclusion of the liquidation process would introduce a disproportionate degree of uncertainty around the timing of any approved LRSP claim, and ultimately increase the future costs liable to be paid by energy suppliers and consumers. Given this, we are minded to approve the claim, subject to the outcome of the Usio liquidation process. At this point, the final amount Shell Energy can claim for credit balances would be adjusted to remove any sums recovered through the liquidation process.

¹⁰ Precisely £354,147.

Next steps

The purpose of this letter is to provide interested parties with an opportunity to make any representations to us, ahead of us making our final decision. We invite any representations by **10 January 2020**.

Responses should be emailed to supplier@ofgem.gov.uk.¹¹ 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, in reaching our final decisions.

We currently expect to confirm our decision in January 2020, in time to enable the approved claims to be recovered from relevant gas and electricity distribution network companies in 2020/21.

Yours faithfully,

Philippa Pickford
Director, Future Retail Markets, Consumers and Markets

¹¹ Although we prefer responses in electronic format, responses can be posted to the address below.