

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 EDF Energy Limited

On 7 September 2023, EDF Energy Limited ("EDF") 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 Zog Energy Limited ("Zog").

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 EDF 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 consent to EDF claiming a LRSP of up to **£23,979.14**.

We are minded-to consent to EDF making a claim for 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;
- 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 EDF Energy Customers Limited as Electricity Supplier of Last Resort](#) and [Direction to appoint EDF Energy Customers Limited as Gas Supplier of Last Resort](#)

² [Decision \(ofgem.gov.uk\)](#)

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 deed with us. Under this True-up Agreement between EDF and Ofgem, Subsequent Levy Claims may be made following the Initial Levy Claim and before a final True-up claim. We are minded-to consider this claim to be a Subsequent Levy Claim for the purposes of the True-up Agreement. This would mean that the final True-up claim would happen next year, or in the years after. This will enable EDF to submit additional LRSP claims with supporting evidence for costs that have not yet been approved by Ofgem. As a result of this, under the terms of the True-up Agreement, we will require a final True-up claim to be submitted in the future. In the meantime, we note that obligations under the True-up Agreement continue to apply and will remain in place until a final True-up claim has been finalised.

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 reaching our final decision and may make 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.

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

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).

Failed Supplier event

On 3 December 2021, we appointed EDF as the SoLR⁵ for Zog 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 EDF as the SoLR to those customers in our decision letter published on 18 March 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 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.

The multiple-claims process involves SoLRs submitting an 'initial claim' for costs faced in serving SoLR customers (typically wholesale commodity costs) in the period immediately after appointment. Each SoLR entered a True-up Agreement with Ofgem to support this process. The True-up Agreements provide for the initial claims to be followed by 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. 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 at the end of the multiple-claim process.

⁵ [Ofgem appoints EDF to take on customers of Zog Energy Ltd](#)

⁶ [Direction to appoint EDF Energy Customers Limited as Gas Supplier of Last Resort to Zog Energy Ltd](#)

⁷ [Appointment of EDF Energy Limited as Supplier of Last Resort for Zog Energy Limited](#)

Following consultation, on 21 September 2022⁸ we published our policy on assessing these true-up claims and it has been applied to subsequent and true-up claims under the True-up Agreements.

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

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 EDF methodology for each cost item claimed. This included determining how each total cost item was calculated based on data sent to us by EDF and ensuring these costs were in line with commitments EDF 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 financing 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.

⁸ [Decision \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/decision)

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

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

EDF claim

EDF indicated at the time of our SoLR appointment process that it would not waive its right to make a claim for LRSP for any costs but that it would claim for the cost of wholesale and financing costs.

The initial claim(s) were consented to on 17 December 2021¹⁰ 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.

Summary of our minded-to decision

Based on the information available and consideration of the circumstances in which the claims for LSRPs by EDF were consented to, and in accordance with the True-up Agreement in relation to customers of the former Zog, Ofgem is minded-to consent to EDF claiming a LRSP of up to £23,979.14.

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 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.

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 in 2022	This Claim as Submitted	Minded-to position on This Claim
1	Wholesale	£4,348,260	£2,204,287.68	£22,414.34	£22,414.34
2	Working Capital	£211,623	£339,727.95	£1,564.80	£1,564.80
	Total			£23,979.14	£23,979.14

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](#)

Reasons for our minded-to decision

Cost category: Wholesale

Retrospective 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.

Given that the retrospective backwardation deductions included in the decision on the subsequent claim were based on our best view of information submitted by the supplier at the time, we provided SoLRs an opportunity to submit evidence in September 2023 to substantiate actual allowances received.

In this claim we have analysed the information provided by suppliers, to:

- Assess the actual retrospective backwardation allowances received by SoLRs from April 2022 to September 2023 based on actual demand (MWh) and updated allowance numbers (£/MWh), adjusted for actual UIG and line losses.
- Assess the claim value for retrospective backwardation by calculating the difference between the deduction amount published in the decision on the subsequent claim and the actual retrospective backwardation allowances received by SoLRs.

Decision:

This claim from EDF includes £22,414.34 for retrospective backwardation. Following the above assessment process, we are minded-to consent to the following claim, subject to EDF providing further evidence during the minded-to consultation period regarding the underlying calculations and methodology used for the backwardation claim amount:

- We expect EDF to submit further evidence with actual demand values for any forecasts that were submitted in September 2023. We also expect EDF to submit further evidence regarding how it arrived at its claim amount of £22,414.34 for retrospective backwardation.

The proposed total claim is £22,414.34. When taking into account the amount approved for the wholesale claim in the decision on the subsequent claim, the total wholesale costs approved to date would be £6,574,962.02.

Table 2: Summary of claims for wholesale

Item	Cost	Initial Claim Approved	Subsequent Claim Approved	This Claim as Submitted	Minded-to position on This Claim
1	Wholesale	£4,348,260.00	£2,204,287.68	£22,414.34	£22,414.34

Cost category: Working capital

Our published policy decision on last resort levy claims True-up process¹² sets out the requirements that SoLRs need to meet in claiming for working capital costs.

Decision:

EDF's claim includes £1,564.80 for the cost of working capital. We consider that the claimed amount is consistent with our overarching assessment criteria and we are minded to consent to the claim as submitted.

Table 3: Summary of claims for working capital

Item	Cost	Initial Claim Approved	Subsequent Claim Approved in 2022	This Claim as Submitted	Minded-to position on This Claim
2	Working Capital	£211,623	£339,727.95	£1,564.80	£1,564.80

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, which includes the interest on working capital.

EDF submitted a claim for the cost of working capital amounting to £1,564.80, supported by evidence that detailed its expenditure relevant to the claim, as well as justification for claiming interest at the specified rate. We consider it appropriate for a SoLR to claim for the cost of working capital used for the purposes of carrying out the SoLR role. EDF's claim for the cost of working capital is based on applying a specified interest rate to the amount that it has claimed for wholesale cost reasonably incurred as a result of acting as SoLR. Through assessing its supporting evidence and rationale, we are satisfied that the rate EDF has applied meets our criteria for assessing whether costs are reasonably incurred, in accordance with SLC 9.4(a). Our decision as to a reasonable rate of interest on working capital in this case has been taken considering our criteria for these SoLR levy claims and what we consider to be reasonable and appropriate in all these circumstances and for these purposes only.

¹² [Decision on last resort levy claims true-up process | Ofgem](#)

In the preceding section we have outlined that we consider the costs claimed for wholesale (backwardation) costs meet our criteria, and are reasonable costs incurred as a direct result of acting as a SoLR for Zog Energy. As a result of that assessment, and our assessment of the evidence submitted to support its claim for the associated working capital costs, we are minded-to consent to EDF's request to claim £1,564.80 for working capital costs.

However, working capital costs may only be claimed on costs that meet our overall criteria for LRSP claims. In light of our minded-to position requesting further evidence to support EDF's wholesale costs claim, we note that our final decision on working capital may be recalculated accordingly.

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 emailed¹³ 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 EDF's claim. We expect to make our final decision in mid-December 2023.

Yours faithfully,

Rohan Churm
Director, Financial Resilience and Controls

¹³ Although we prefer responses in electronic format, responses can be posted to the address below.