Neutral Citation Number: [2023] EWHC 2891 (Admin)

Case No: AC-2023-LON-0000197

IN THE HIGH COURT OF JUSTICE
KING'S BENCH DIVISION
ADMINISTRATIVE COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 17 November 2023

Before :

MR JUSTICE BRIGHT

- -

Between :

The King
(on the application of
E.ON Next Energy Limited)

Claimant

- and -

The Gas and Electricity Markets Authority

Defendant

- -
- -

Duncan Sinclair (instructed by Pinsent Masons LLP) for the Claimant
Jessica Simor KC and Nicholas Gibson (instructed by The Office of the General Counsel to the Gas and Electricity Markets Authority) for the Defendant

Hearing dates: 17th, 18th October 2023

- -

JUDGMENT

Mr Justice Bright:

Introduction

1. The last 2-3 years have been a turbulent time in the energy market. In 2021 there were sharp rises in energy wholesale prices, to levels that few, if anyone, in the industry had foreseen or prepared for.

2. Suppliers could not simply pass these price rises onto consumers, because the retail market is subject to a price cap. The result was a price squeeze, which in the autumn of 2021 resulted in a significant number of suppliers going out of business. This in turn meant that, in order to ensure continuity of energy supply for consumers, the failed suppliers had to be replaced by other suppliers – referred to as 'Suppliers of Last Resort' ("SoLR"s). Three of the suppliers that failed were Igloo, Symbio and Enstroga. These three suppliers were replaced by the Claimant, which was appointed as SoLR for the relevant consumers on 1 October 2021.

3. In some circumstances, with the consent of Ofgem, a SoLR can recover costs and other sums associated with its role as SoLR, by making a claim levied against the industry as a whole (and which, therefore, is ultimately borne by consumers) – referred to as a Last Resort Supply Payment ("LRSP"). This judgment relates to the Claimant's attempts to recover various amounts which it said were associated with its role as SoLR for Igloo, Symbio and Enstroga, and Ofgem's decision not to allow this.

4. More specifically, this judgment concerns three decisions, all made by Ofgem on 20 December 2022 (the "Decision(s)"), that the Claimant could not claim certain specific costs which I refer to in this judgment using the generic term

'shaping/imbalance costs' (explained below). The Claimant seeks to challenge these Decisions, by way of judicial review.

5. The volatile market conditions of 2021 were unprecedented. So too was the scale of the failure of suppliers and the urgent need to replace them. Accordingly, the decisions that had to be made, and the commercial exigencies giving rise to them, were novel.

6. There had of course been previous instances of supplier failure, albeit they arose on different facts and gave rise to different issues from those in play in this case. One example of this is the failure of Extra Energy Supply Limited, in November 2018, and its replacement by ScottishPower Energy Retail Limited. This was the subject of the judgment of Thornton J in *R (ScottishPower Energy Retail Limited) v The Gas and Electricity Markets Authority* [2022] EWHC 37 (Admin). However, in no previous instance that either party was aware of had a SoLR sought to recover shaping/imbalance costs, following its appointment as the replacement for a failed supplier.

The parties; representation

7. The Claimant ("E.ON") is a retail supplier of electricity and gas. It operates under licences that are issued and enforced by the Defendant ("GEMA").

8. GEMA is the independent regulator of gas and electricity markets in Great Britain. It operates via the Office of Gas and Electricity Markets ("Ofgem"), which carries out all the day-to-day work necessary to enable the Defendant to discharge its functions, including all the correspondence and decision-making relevant to this case.

9. E.ON was represented by Mr Duncan Sinclair; GEMA by Ms Jessica Simor KC, leading Mr Nicholas Gibson. I am grateful to them for the assistance I received, and to their respective teams for all the hard work done in preparing the case for trial.

Ofgem's statutory role

10. Pursuant to s. 4AA of the Gas Act 1986 and s. 3A of the Electricity Act 1989, the principal objective of Ofgem is to protect the interests of existing and future gas and energy consumers, wherever appropriate, by promoting effective competition between persons engaged in the provision of gas and electricity or in connected commercial activities.

11. Pursuant to ss. 5 and 7A of the Gas Act 1986 and ss. 4 and 6 of the Electricity Act 1989, suppliers must (subject to limited exceptions) hold, and operate subject to, licences issued by GEMA. These licences are subject to Standard Licence conditions (s. 8 Gas Act 1986 and s. 8A Electricity Act 1989) ("SLC"s).

SLC 8 and SLC 9

12. Ofgem's power to direct a supply licensee to take over responsibility for a failed supplier's customers, by appointing it as the SoLR, is addressed under SLC 8, in particular as follows:

> "**Condition 8. Obligations under Last Resort Supply Direction**
>
> **Last Resort Supply Direction**
> 8.1 The Authority may give a Last Resort Supply Direction to the licensee if it considers that:
>
> (a) a circumstance has arisen that would entitle it to revoke the Electricity Supply Licence of an Electricity Supplier other than the licensee (for this condition and condition 9 of this licence only, the "other supplier"); and

(b) the licensee could comply with the Last Resort Supply Direction without
significantly prejudicing its ability:
(i) to continue to supply electricity to its Customers' premises; and
(ii) to fulfil its contractual obligations for the supply of electricity.
…
Licensee's obligations
8.3 In complying with the Last Resort Supply Direction, the licensee must take all reasonable steps to honour any commitment made to the Authority before the Authority gave it a Last Resort Supply Direction.
8.4 Except in the circumstances set out in paragraph 8.5, the licensee must comply with a Last Resort Supply Direction."

13. LRSPs are addressed under SLC 9, in particular as follows:

"**Condition 9. Claims for Last Resort Supply Payment**

Ability to make claim
9.1 If the licensee has received the Authority's consent under paragraph 9.5, it may make a claim for a Last Resort Supply Payment, under standard condition 38 (Treatment of Payment Claims for Last Resort Supply) of the Distribution Licence, from each Relevant Distributor.
…
Process for making claim
9.3 If the licensee intends to make a claim for a Last Resort Supply Payment, it must:
(a) give notice to the Authority of its claim; and
(b) give the Authority a calculation of the amount claimed with information to support that calculation, no later than a date notified to it by the Authority or, in the event that no such date is notified, five years after the date on which the Last Resort Supply Direction to which the claim relates stops having effect.
9.4 The total amount of the Last Resort Supply Payment (for this condition only, "the relevant amount") to be claimed by the licensee must not exceed the amount by which:
(a) the total costs (including interest on working capital) reasonably incurred by the licensee in supplying electricity to premises under the Last Resort Supply Direction and a reasonable profit, plus
(b) any sums paid or debts assumed by the licensee to compensate any Customer in respect of any Customer Credit Balances, plus
(ba) any additional (actual or anticipated) interest and finance costs (including fees, costs and expenses incurred in arranging such financing) associated with an arrangement approved in accordance with Clause 9.7C, are greater than:
(c) the total amounts recovered by the licensee through Charges for the Supply of Electricity to premises under the Last Resort Supply Direction (after taking all reasonable steps to recover such Charges).
9.5 If the Authority considers it appropriate in all the circumstances of the case for the licensee to make the claim notified to it in accordance with

paragraph 9.3, the Authority will give its consent to the licensee.
9.6 The Authority may determine:
(a) that an amount other than the one calculated by the licensee is a more accurate calculation of the relevant amount.
(b) with the consent of the licensee, that the period over which the relevant amount should be paid should be longer than a single financial year in order to mitigate the impact on consumers."

Shaping/imbalance costs

14. Suppliers buy energy from the wholesale market. Typically, much of their purchase arrangements are by way of bulk long-term contracts. However, the customer demand that eventuates over the period of these long-term contracts will be affected by unpredictable factors (e.g. customer numbers and weather conditions). This gives rise to shaping and imbalance and the costs associated.

15. Closer to the time of energy delivery, when demand forecasts are more accurate, suppliers use more granular contracts to match supply and demand more closely. 'Shaping' costs are the costs they incur in buying or selling these granular contracts.

16. If the eventual demand does not match the contracted supply, the suppliers affected will be subject to 'imbalance' charges, which are imposed by the network system operators and reflect their costs in balancing the system.

17. Shaping/imbalance costs therefore are among the charges that suppliers pay, as part of the total costs that they incur when supplying electricity. In principle (subject to reasonableness), they are a cost within SLC 9.4(a).

The 2016 Guidance on SoLR orders

18. On 21 October 2016, Ofgem published fresh Guidance on SoLR orders ("the 2016 Guidance"). This stated as follows:

" **Overview**

…

This document sets out our process for deciding whether and how to exercise our powers to appoint a SoLR or if this is not feasible to seek the Secretary of State's consent to apply to the court for an energy supply company administration order.

The guidance provides information on the approach we intend to follow in taking these decisions, including the criteria for selection of a SoLR where we decide that is the appropriate course of action. The guidance also sets out the information we are likely to seek from industry parties. This will enable them to prepare in advance to respond to a supplier failure situation.

This guidance has been issued to assist industry parties, their advisors and insolvency practitioners to understand our current powers, policies and procedures. The circumstances of particular supplier insolvencies may however require us to adopt a different approach.

…

Executive Summary

…

The guidance cannot take account of unforeseen circumstances that might arise during a particular failure. Such circumstances may necessitate changes (which may be substantial and at short notice) to the policies and procedures in this document.

…

2. Approach to supplier failure

This Chapter sets out the steps we would take in order to gather the information we need to decide the appropriate course of action. The arrangements steps we would take to determine whether it is feasible to appoint a SoLR or whether to seek the consent of the Secretary of State to apply for an energy supply administration order are described below.

…

Collect information from potential SoLRs

…

Claims for last resort supply payments

2.24. The role of SoLR represents a significant logistical challenge to a supplier. The supplier is likely to incur increased administrative costs and will have to implement additional energy purchasing arrangements. These will have to be activated and managed within a very short period of time. However, there are also potentially valuable commercial benefits to a SoLR. It will not have the normal acquisition costs (for example, paying commission to price comparison websites) and will have the opportunity to convert the customers it has acquired as a SoLR to normal contracts.

2.25. Electricity and gas suppliers' licences permit them (in some circumstances) to make a claim for the otherwise unrecoverable costs that they have incurred in being a SoLR. This would be paid by a "levy" on gas transporters and electricity distributors' Distribution Use of System (DUoS) charges.

2.26 We would generally prefer a SoLR not to make a claim via these arrangements for costs it has incurred carrying out its role although we

recognise that circumstances may exist which would justify a departure from this general rule. The circumstances of every supplier failure are different and there may be some where a SoLR incurs costs which would not otherwise be recoverable. An efficient SoLR should be able to minimise its exposure to these costs.

2.27. Following appointment of a SoLR that had not waived its right to make a claim, we will decide on a case-by-case basis whether it might be appropriate for a SoLR to make a claim on the levy. We would consider whether the amount of any claim or the reasons for any claim were reasonable. For example, we may in certain circumstances consider it appropriate to approve the claim where it relates to costs associated with the protection of customers who held a credit balance with the failed supplier as outlined above

…

3. SoLR selection criteria

3.1. This Chapter sets out the selection criteria that Ofgem is likely to use in assessing which supplier(s) to direct to be a SoLR. The criteria should be read in conjunction with the information request in Appendix 4. The criteria may vary depending on the circumstances of the failure – this is therefore provided for guidance only.

General information

Volunteer SoLR

3.2. *Ofgem policy*: Other things being equal, preference will be given to those suppliers who volunteer for the role of SoLR.

3.3. *Reason*: We consider that customers' interests will be best served by a supplier that wants to be a SoLR, provided we are satisfied that the volunteer has the capacity and resources to fulfil the role.

…

Last resort supply payments

3.5. *Ofgem policy*: Preference will normally be given to those suppliers who state that they will not make a claim for last resort supply payments although we may depart from this depending on the specifics of the supplier insolvency.

3.6. *Reason*: Ofgem would prefer a SoLR not to make a claim via the levy arrangements for costs it has incurred carrying out its role. We would expect an efficient SoLR to be able to cover its own costs and not rely on additional payment through the levy arrangements. There may be circumstances in which this is not possible such as where there are costs associated with the protection of customers who held a credit balance with the failed supplier as outlined in paragraph 2.23.

…

Deemed contracts and customer balances

3.23. *Ofgem policy*: A failed supplier's customers should not generally expect to be protected from paying increased prices. However, deemed contracts can reflect no more than the reasonable costs of supply (including costs attributable to the purchase of gas or electricity at short notice), together with a reasonable profit. In certain circumstances it may be appropriate for potential SoLRs to address the loss of this balance (e.g.

> through applying a credit to the customer's account) in order to ensure that customers are not unduly affected.
> 3.24. *Reason*: In the case of a failed supplier, our primary interest in customer protection means ensuring continuity of supply but it may be appropriate in the overall interests of consumers for some steps to be taken to address the implications for particular customer groups associated with loss of a credit balance.
> 3.25. *Criteria*: We will consider the potential SoLR's prices, taking into account the explanation given by the supplier for the difference, if any, between its deemed contract prices in normal circumstances and its deemed contract prices under a last resort supply direction. We will also assess the supplier's proposals in respect of consumers who have credit balances with a preference for those agreeing to honour these balances.
> …
> **Assessment of information**
> …
> 3.27. We would always prefer to be able to appoint a SoLR that had consented to the role. However, if no suitable supplier volunteers to be a SoLR, we will consider using our powers to direct a supplier without its consent where we are satisfied that they are able to perform this role.
> 3.28. We have the power to appoint any supplier as a SoLR so long as we think they could carry out the role without significantly prejudicing their ability to supply their own customers and to fulfil their contractual obligations for the supply of gas and electricity. We will consider as potential SoLRs all suppliers that we think meet these criteria, irrespective of whether they have responded to our information request. We will select a SoLR from those suppliers we consider to be best placed to carry out the Role
> …
>
> **4. What happens after a SoLR appointment**
> …
> **Revocation date, appointment date and duration of direction**
> …
> 4.3. The direction to be a SoLR cannot last longer than six months. After that time the SoLR remains the supplier for any customers with which it has deemed or other contracts. However, after the direction ceases to have effect the SoLR's deemed contract price must revert to its normal rate."

Previous supplier failures and SoLR appointments, before 2021

19. Suppliers failed from time to time, even before the difficult market conditions of 2021. Each failed supplier was replaced, with another being appointed as the SoLR to the relevant consumers in each case.

20. As anticipated by the 2016 Guidance at §2.24, SoLR appointments have always been made within a very short period of time. Up until now, there have invariably been other suppliers willing to take on the SoLR role because of the commercial attraction of acquiring additional customers. The process of appointing a SoLR therefore has tended to be competitive. I note from the judgment of Thornton J in *ScottishPower* at [9] that the evidence before her was to the same effect.

Ofgem's published LRSP criteria, before 2021

21. Following such appointments, the SoLRs have sometimes sought to claim LRSP monies, i.e. the levy referred to in the 2016 Guidance at §2.25 (and elsewhere). Because a levy on the industry as a whole affects all other suppliers, Ofgem conducts a consultation, in the course of which it publishes (and seeks comments on) the criteria that it uses when considering LRSP claims. I was shown the materials relating to seven such consultations from 2017 to 2020, in every one of which Ofgem provided published criteria ("the Ofgem LRSP criteria") 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."

22. The suppliers to whom these criteria were published included E.ON, which took an active part in several of these consultations.

23. It is important to note that, while there were several previous instances of SoLRs making LRSP claims, none of the seven in evidence before me (nor the claim in *ScottishPower*, discussed under the next heading) were claims in respect of wholesale energy costs; and certainly not in relation to shaping/imbalance costs.

The judgment of Thornton J on the significance of the Ofgem LRSP criteria

24. Although not in evidence before me, I note from the judgment of Thornton J in *ScottishPower* that a similar consultation occurred in that case, issued on 7 December 2020. The Ofgem criteria were attached as an Annex to the consultation document and were said to comprise Ofgem's methodology: see at [21], [65] and [85].

25. In that case, ScottishPower argued (among other things) that Ofgem erred in disallowing its LRSP claim by reference to factors not referred to in the published Ofgem LRSP criteria and/or failing to follow those criteria. Thornton J rejected these arguments, saying at [85]:

> "As is apparent from the consultation document letter and the wording of the criteria themselves, they were used by Ofgem as part of its assessment process but not as an empirical, complete or exclusive tool in its assessment. They provided essentially subjective heads of assessment that Ofgem considered as part of a wider overall analysis of the merits of the claim. Used in this way, as Ofgem did, they are consistent with the regulatory

> framework which permits Ofgem a broad discretion in deciding on an LRSP claim, to be exercised on a case by case basis in accordance with Ofgem's principle objective to protect the interests of existing and future consumers (Condition 9.5 of the SLCs and s. 4AA Gas Act 1986 and s. 3A Electricity Act 1989)."

26. In short, it was legitimate for Ofgem to take its LRSP criteria into account; but Ofgem was not bound by them, because of the broad discretion given to it by SLC 9.5.

The price cap; its effect in 2021

27. On 19 July 2018, the Domestic Gas and Electricity (Tariff Cap) 2018 came into force. This primary legislation required that Ofgem design and apply a price cap to all standard variable and default ("SVT") rates charged for the supply of gas or electricity under domestic supply contracts.

28. The price cap became effective from 1 January 2019 and was reviewed and updated at regular intervals. The price cap period relevant to this case was Cap Period 7, which ran from 1 October 2021 to 31 March 2022.

29. In considering the price cap, Ofgem must have regard to a number of matters, including the need to ensure that, considering the market as a whole, a notional energy supplier can recoup its efficient costs for serving SVT customers. It calculates the price cap using a bottom-up assessment of the costs that an efficient notional energy supplier is likely to incur in supplying energy to default customers. These include shaping/imbalance costs.

30. In doing so, Ofgem has regard to suppliers' ability to finance their activities, assessed against the other objectives of the price cap. The cap may result in suppliers losing money, if they are inefficient or for another reason incur costs

above the amount they can recover from within the price cap. However, if a supplier has lower costs than those used in calculating the price cap, it can make a greater return. When the cap was introduced, it was based on Ofgem's assessment of efficient costs and a 'normal' profit level (1.9%), which it considered would enable an efficient supplier to finance its activities. Importantly, the assumptions made by Ofgem in arriving at this assessment included the expectation that suppliers hedged their energy purchase in advance and so had a measure of protection against volatility.

31. However, the extreme volatility of the market in 2021 led to extraordinary rises in wholesale energy costs. Those suppliers which had not purchased energy in advance in line with the price cap's hedging assumption were faced with significantly higher energy costs than the cap allowed them to recover from their customers. This is what led to an unprecedented number of supplier failures – 29 suppliers between July 2021 and May 2022. It also meant that Ofgem needed to appoint SoLRs on an unprecedented scale, to replace the failed suppliers.

The appetite of suppliers to act as SoLRs, in 2021

32. Being appointed as a SoLR necessarily means acquiring new customers. Historically, this had generally been regarded as positive. However, such new customers would inevitably increase the relevant supplier's demand for energy, to an extent capable of causing a demand/supply imbalance and, thus, shaping/imbalance costs. The magnitude of any such shaping/imbalance costs would depend on the number of new customers, other demand-side factors and the relevant supplier's forward-purchasing strategy – including hedging.

33. E.ON's evidence was that, in the market conditions of 2021, it therefore no longer regarded the acquisition of new customers as positive, because the sector was loss-making. Acquiring new customers would be a burden rather than an opportunity. It would mean incurring substantial costs, which could not be recovered from customers because of the price cap.

34. E.ON further said that it only offered to act as SoLR for Igloo, Symbio and Enstroga because it was concerned that, if it did not, it would face an involuntary appointment in respect of less attractive failed suppliers.

35. I accept that E.ON volunteered on this occasion in part, at least, for this reason. I also accept that acquiring new customers was less attractive than it had been when market conditions had been easier. However, I do not accept that the acquisition of new customers can have been seen by E.ON as wholly negative, in 2021. Even if the business of these customers would be loss-making in the short term, E.ON must have expected that, in due course, market conditions would stabilise and its operations would once again be profitable. At that point, more customers should, in principle, mean higher profits.

36. Nor do I accept that this was the view of all or most other suppliers. I have received no evidence that sheds any real light on their views of the desirability of acquiring new customers, in 2021. It does seem that the general appetite to be appointed as a SoLR was somewhat diminished – there was evidence that Ofgem approached suppliers to replace Igloo, but only three volunteered. However, there seems still to have been at least a degree of competition among potential appointees. As I discuss below, during the course of the process leading to its appointment, E.ON revised the terms that it was offering to

Ofgem, so as to make its bid more attractive. This presumably was because E.ON perceived a risk that other suppliers might be offering better terms than E.ON's original offer, and that a rival bid might therefore be preferred.

E.ON's offer to act as SoLR for Igloo customers

37. Igloo ceased trading on 29 September 2021. On the same day, Ofgem emailed suppliers with a Request for Information ("RFI") in relation to each of Igloo, Symbio and Enstroga.

38. The RFIs included an annex dealing with Frequently Asked Questions, which said as follows:

> "**4. What costs are eligible to be reclaimed through the levy?**
>
> The supply licences (SLC 9.3 and 9.4) 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. This may include, if appropriate, certain costs of honouring credit balances for <u>domestic</u> customers. As above, we prefer for suppliers to waive their right to make a claim. We expect any SoLR to factor in the costs it expects to incur in carrying out the SoLR role based on the information provided into its proposals to be a SoLR. We would consider and decide on a case by case basis whether the amount of any claim or the reasons for any claim were reasonable. We have set out further details on this in paragraphs 2.24 – 2.27 of our SoLR guidance."

39. Following a meeting on 30 September 2021, E.ON provided its response to the RFI for Igloo (but initially declined in relation to Symbio and Enstroga). Of particular relevance are the responses to questions 3, 24, 25 and 27, as follows:

> "***3. Please confirm whether the Licensee wishes to be considered to be a SoLR for all the customers in*** **Igloo Energy's** ***portfolio.***
>
> <u>Please note, the details of our bid outlined below and our offer to volunteer as SoLR is conditional on approval by our parent company E.ON SE, including the Management Board and Supervisory Board where required.</u>

Yes, we would be prepared to act as SoLR for Igloo, subject to the conditions set out below. In this time of significant disruption in the energy market, our experience and expertise in migrations, having undertaken the UK's largest ever migration, plus our capability and expertise in managing wholesale market risks; puts us in a strong position to protect the customers of Igloo and to provide accurate assessments to Ofgem of the costs and risks involved.

Given the current state of the retail market, we are concerned that, when assessing suppliers' bids, the SoLR process allows for a wide range of general assumptions that can materially affect the appearance of a supplier's likely levy claim. We have based our estimates of expected levy claim on sensible assumptions, based on our expertise and with complexities we have identified factored in. Ofgem must account for this when comparing bids and be wary of low estimated levy claims that ignore complexities that will affect any appointed SoLR.

Our offer to act as SoLR for Igloo would be based on receiving the following assurances in writing from Ofgem, in line with the email sent by Ofgem on 30th Sept 2021 at 12:59:
a) We would be reimbursed based on our Last Resort Supply Payment (LRSP) claim (adjusted up or down to reflect true costs), subject to review by Ofgem and in line with industry process:
- For electricity: initial payment from 3 months of an approved levy claim or claims
- For gas: payment from the next financial year where a claim or claims have been approved for Gas. i.e. from April 2022 if approved in Jan 2022

b) To expedite reimbursement, multiple LRSP claims would be allowed, and payments made in line with a)
c) Ofgem will consider any LRSP claim from E.ON expeditiously, and whilst claims may periodically be settled during the time set out, all claims submitted and approved by January 2022 should be paid to E.ON by 31 December 2023.
d) Following the process outlined above, an expectation that at least 50% of claims to have been paid by the end of December 2022.
e) If any form of government scheme or support measures, including working capital facility or other financial assistance is introduced for suppliers appointed as a SoLR or in some other way rescuing customers from failed suppliers (whether on a voluntary basis or otherwise), E.ON shall be able to apply, subject to any financial or other conditions imposed by government, for any such scheme or measures in respect of Igloo in the event that it is appointed as SoLR.
f) Beyond the expected LRSP claim outlined in this RFI, E.ON needs to be able to claim ~~recover~~[1] any other costs that arise from acting as SoLR for Igloo, including where the initial cash outlay estimate was too low, or where additional costs were incurred.

Our Kraken platform gives us flexibility to successfully undertake large

[1] My underlining/strike-out – see below

customer migrations, as we have proven with the npower and E.ON migrations with over 5 million customers migrated so far. We are in a position to play a key role in helping Ofgem protect customers through this crisis. However, as we protect more customers, we must continually assess impact on the timing of our own migration of existing customers onto our E.ON Next Kraken platform (expected to complete in Q2 2022 in advance of the implementation of the Faster Switching programme). Should there be any delays to this timetable as a result of us helping to protect customers during this period we will need pragmatic support from Ofgem to navigate certain regulatory impacts.

The maximum £10m E.ON contribution will be against wholesale costs, but we reserve the right to reduce this contribution if we believe that our levy claim for wholesale, or any other costs, has not been treated fairly.
...

24. Please state if the Licensee agrees to waive its right to make a claim for a Last Resort Supply Payment before being appointed a SoLR

No. E.ON would not waive its right to make a claim for a Last Resort Supply Payment (LRSP) before being appointed a SoLR.

We are willing to contribute a maximum of £10m to the estimated emergency energy purchasing costs but this figure may reduce as a result of changes to the assumptions / variables outlined below.

Unfortunately, due to unprecedented wholesale costs and their interaction with the Price Cap, our reasonable costs to supply Igloo's customers at short notice significantly exceed the amount at which we would be able to set the charges for the supply of gas and electricity. Power and Gas prices are currently at a significant premium compared to the price at which energy was pre-purchased for existing standard variable customer supply volumes between 01 October 2021 and 30 September 2022. This represents a significant investment over a 5-year period and inhibits our ability to absorb other unavoidable and unrecoverable costs associated with acting as a SoLR.

We would, however, use our experience from a wide variety of recent customer migrations to reduce the magnitude of costs incurred, therefore reducing our LRSP claim.

25. If the answer to Q24 is no, please indicate whether the Licensee agrees to meet any costs of credit balances of Igloo Energy's customers before making a claim for a Last Resort Supply Payment

No. E.ON would protect the credit balances of all current and former domestic and non-domestic customers of Igloo but it would be necessary to claim ~~recover~~[2] all costs (including costs of associated working capital).

[2] My underlining/strike-out – see below

This would include interest on credit balances applied by Igloo and the credit applied for Igloo's 'refer-a-friend' scheme which we note are uncertain at this time.

…

27. If the answer to Q24 is no, please specify, as clearly as possible, the type of costs the Licensee would expect to claim for under the Last Resort Supply Payment, excluding the recovery of any costs of customer credit balances above those limits specified in Q25, or recovery of those costs above the limits specified in Q26a, 26b and 26c. If possible, please indicate what you would expect the value of these costs to be.

In addition to the cost of customer credit balances, E.ON sees that it would be necessary to claim for costs across the following cost categories, with estimated costs provided (based on information currently available):
Migration costs (including but not limited to customer communication costs, IT costs, TSA

- costs, any potential ransom costs and internal costs) of c. £6.2m
- IT investment of c. £0.9m
- Additional emergency wholesale procurement costs of c.£117m (which we will claim back via the LRSP process), as outlined below

Additional emergency wholesale procurement costs:
Given the significant rise in the wholesale market, and our inability to claim ~~recover~~ our costs through the SVT price cap given the purchasing of such significant volumes of energy up front, we will need to claim for a significant proportion of wholesale purchasing costs.

It should be noted, however, that E.ON will look to absorb some of these costs itself as outlined in the table below:

[There then followed a table setting out various costs E.ON would contribute, including any SVT hedge cost]

Whilst all costs are subject to change it is important to highlight the current volatility of wholesale market costs. The indicative emergency wholesale costs outlined above have been calculated based on the forward curve as on 29/9/21 and we expect continued rises until we are able to lock in purchases. Any further changes in consumption, price, imbalance costs or customer churn assumptions would be reflected in our LRSP and will be passed through, in full to our claim. For the avoidance of doubt, E.ON's contribution as outlined above is capped, but E.ON's contribution can still reduce, e.g. as a result of changes to the assumptions / variables outlined above.
In addition, we would need to claim for the following costs categories, however indicative costs are not currently available for these items:

- Working capital costs - initially at a rate of 5.73%, which will vary based upon our WACC, and which will also vary depending upon the timing of payments we receive through the levy
- Imbalance charges

- Costs resulting from the actions of Auto-switchers, for example (but not limited to), processing losses and associated debt collection (or bad debt costs)."

40. I should explain that the original text, as sent on 30 September 2021, used the word "recover", in the responses to 3(f) and 25. This word was replaced with "claim", as explained below.

41. I should also note that, although the response at 27 refers only to "imbalance costs" and "imbalance charges", it was common ground that, in the industry, the distinction between shaping costs and imbalance charges is not always strictly observed. People sometimes use a single one of either term to include both. E.ON's response to the RFI therefore should be treated as referring to shaping/imbalance costs, collectively, wherever it refers to "imbalance costs" and "imbalance charges".

42. On 1st October 2021, Ofgem asked some follow-up questions, to which E.ON responded (in particular) as follows:

> "**1. Please could you provide more detail on the circumstances in which you would provide the £10m contribution to wholesale costs for Igloo? What circumstances would have to be met for EON to provide the full £10m contribution? Under what circumstances would this contribution be reduced to £0?**
> Our expectation, based on the estimates we provide in our RFI and fair treatment by Ofgem of any levy claims, is that our contribution to wholesale costs for Igloo would be £10m. There are two circumstance in which this could reduce:
> - If the emergency wholesale costs incurred are lower than our estimate, for instance due to a drop in prices or because consumption is lower or churn is higher, then our contribution would reduce.
> - We reserve the right, at our discretion, to reduce our contribution if any of our claims for wholesale or other costs are in our opinion treated unfairly, for example if costs we can evidence have been reasonably incurred are disallowed from any claim. We believe this is necessary as in the SoLR process we do not earn a margin on our costs, which, in a normal contract, would compensate us for taking on the risk of incurring costs that are subsequently disallowed.

We would welcome a discussion on this."

43. Following a discussion on the same day, at 19:45 on 1 October 2021, E.ON increased the level of the contribution to £15 million, and also indicated its willingness to act as SoLR in relation to Symbio and Enstroga:

> "We would like to increase our contribution towards costs from £10m to £15m for Igloo. We reserve the right, at our discretion, to reduce our contribution if any of our claims for wholesale or other costs in respect of Symbio, Enstroga or Igloo are in our opinion treated unfairly, for example if costs we can evidence have been reasonably incurred are disallowed from any claim."

E.ON's appointment as SoLR; the Comfort Letter

44. At 22:09 on 1 October 2021, Ofgem sent an email recording their agreement with E.ON that the word "recover" should be replaced by "claim" in the response to the RFI at 3(f) and 25.

45. Finally, at 23:00 on 1 October 2021 – a further email confirming the appointment as SoLR in relation to Igloo, Symbio and Enstroga.

46. Attached to the email confirming the appointment was a letter from Ofgem, dated 1 October 2021 and stating as follows:

> "**Supplier of Last Resort Process for Igloo Energy Supply Ltd; Symbio Energy Ltd; and Enstroga Ltd**
>
> Further to our email to you of today's date at 22.09, we are pleased to confirm the following:
>
> The profile that you have provided is in theory in line with the current industry processes. These allow for, in relation to costs incurred and approved by Ofgem:
> 1. Initial payment from 3 months of an approved levy claim or claims for Electricity
> 2. Payment from the next financial year where a claim or claims have been approved for Gas. Ie from April 22 if approved in Jan 22
>
> In practice we envisage a phased approach of multiple levy claims which

would allow for an early claim in respect of initial costs incurred and with Ofgem expected to be able to make a decision quickly followed by additional claims for costs incurred.

While there would not be a final Ofgem decision point by 30th of September, where you make an early claim and have provided robust evidence that costs were efficiently incurred, Ofgem would be in a position to make a decision in a timely manner. This would be followed by further claims which would allow for the recovery of additional costs and corrections. If the corrections reduced the amounts of previous claims these would be set off against additional amounts claimed to ensure all claims were accurate and reflected efficient costs incurred. Furthermore, you have committed to Ofgem as part of your SoLR bid that if there any corrections or amendments which cannot be set off you would repay any over claimed costs.

Ofgem acknowledges that E.ON intends to give notice of its intention to make a claim for a Last Resort Supplier Payment under SLC 9.3(a). Ofgem acknowledges E.ON's estimate of costs in its RFI but note that any subsequent claim for costs would need to be based on costs incurred as per SLC9.4. Ofgem acknowledges that E.ON's claim would be based on your RFI which, for the avoidance of doubt, includes (but is not limited to):

o The cost of meeting credit balances, the cost of migration and other related project costs, and the incremental cost of energy purchased above our normal hedging policy.

o Any administrative costs associated with managing Green Supplier customers with a live auto-switching site agreement through the Last Resort Supply Payment process

o Any additional costs relating to the ongoing provision of the existing platform prior to migration

Ofgem acknowledges that, shortly after receiving a Last Resort Supply Direction E.ON will make an initial notice of its intention to make a claim for a Last Resort Supplier Payment under SLC 9.3(a), and that this initial notice will specify the cost categories E.ON outlines in its RFI (but will not include costs incurred initially). Ofgem will send E.ON an acknowledgement of receipt of this Notice before [30 September 2021], noting that any subsequent claim for costs incurred within the categories outlined is subject to Ofgem's review, and noting that there could be additional cost categories not reasonably anticipated or identified based upon the information currently available, and that these would also be subject to Ofgem's review.

This will help Ofgem to process actual claims and provide comfort to E.ON the claim will be paid. It is not possible to accurately forecast the total cost from the outset and E.ON have agreed to minimise any costs where possible to do so.

We confirm we will consider any LRSP claim from E.ON expeditiously, and whilst claims may periodically be settled during the time set out, all claims submitted and approved by January 2022 should be paid to E.ON by

> 31 December 2023. Following the process outlined above given the cost profile estimated we would expect at least 50% of claims to have been paid by end of December 22. We will require you to provide full disclosure on data and information in support of your claim and, consistent with any claims received from other suppliers, may also require that you undertake an internal audit as well.
> …
> Our decision to appoint you as SoLR for those companies is based on this letter, together with your RFI submissions and our other correspondence, including the contents and attachements of our above mentioned email of today's date."

47. E.ON's case before me was heavily based on this letter, which it characterised as "the Comfort Letter". Ofgem disputed the accuracy of this characterisation, but in this judgment, for convenience, I refer to it as "the Comfort Letter".

Consultation on a multi-stage claims process; the decision to implement it

48. The circumstances in which SoLRs were appointed in 2021 made it inevitable that the LRSP claims that would follow would be very substantial. This had obvious cash-flow implications. As a result, E.ON – and, I suspect other SoLRs – wanted their LRSP claims to be processed swiftly.

49. This is reflected in the Comfort Letter. Before me, E.ON relied on the passages in it that were concerned with the kind of costs E.ON would claim for and how they would be treated. I have set out almost the entirety of its text, in order to show that much of it was not concerned with this, but related, rather, to the timeline for the LRSP process. My impression from the Comfort Letter is that, in so far as it was apparent to Ofgem that E.ON required to be comforted, this was in relation to timing.

50. Ofgem therefore consulted on a multi-stage claims process. The scheme ultimately adopted was as follows:

i) There would be an early initial claim, which would be dealt with on an interim basis, and payment made accordingly – the "Interim Claim Approved".

ii) There would then be a further claim – the "True-Up claim", which would contain the SoLR's final figures.

iii) Ofgem would initially respond to this with a provisional decision – its "Minded-to" position.

iv) The SoLR would respond to this, and Ofgem would then make its final decision – such as the Decisions that are the subject of this claim.

51. First, Ofgem consulted with suppliers by a letter dated 29 October 2021. Importantly, the letter was not confined to the timeline. It also discussed (to some extent) the kind of costs that SoLRs were expected to claim for, and how such claims would be assessed. The letter explained Ofgem's intentions as follows:

> "**Last Resort Supply Payment claim (LRSP) process**
>
> The purpose of this letter is to set out and invite comment on the changes we are proposing to the process for a Supplier of Last Resort (SoLR) to make a claim for a Last Resort Supply Payment (LRSP, often referred to as a "levy claim"). We are making these changes as we recognise that the current market conditions are extremely challenging. We want to work collaboratively with suppliers and the wider industry to ensure that the SoLR process can continue to protect consumers.
>
> In support of this, our proposals seek to clarify the types of costs SoLRs may seek to recover, and to expedite the process in order to facilitate faster payment to SoLRs. We consider these changes will ensure that we and the wider industry are best placed to respond to the current market challenges. Our process is aimed at ensuring we can continue to act quickly

> to appoint a SoLR to supply all affected customers when a supplier exits the market, and to protect domestic customers' credit balances.
>
> We have set out in more detail in the annexes to this letter how the current claim process works, and the changes we are proposing, given the current market conditions. We will continue to monitor market conditions closely and if necessary may propose further changes to those outlined in this letter."

52. Annex 1 to the letter was headed "What can be claimed for via the LRSP". It made it clear that LRSP claims could include wholesale costs, even though these had not historically been the subject of such claims. It also made specific reference to what it referred to as "trades to shape positions closer to delivery" – which I understand to be a species of what was otherwise referred to before me as shaping costs. It said that each such claim would be assessed on its merits, depending on the particular terms and circumstances, and "the criteria we use is set out in Annex 2".

53. Annex 2 to the letter was headed "How Ofgem assesses current levy claims". It stated as follows:

> "Our main methodology criteria for assessing whether a SoLR levy claim is reasonable in all circumstances of the case 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.
> • **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.

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

54. The text of Annex 2 was not precisely the same as the previous Ofgem LRSP criteria. In particular, what had been the final sentence of the first bullet-point was now omitted; the third bullet-point was somewhat different; and the final bullet-point had a different title. However, the substance of the first two bullet-points was unchanged in this text; and the second bullet-point – "Directly incurred as part of the SoLR role" – was wholly identical.

55. Following responses from consultees, Ofgem published its decision to implement the multi-stage claims process on 1 December 2021. As well as discussing the division of the process into separate stages, the decision letter also gave Ofgem's views on wholesale costs, in particular as follows:

> "With regards to wholesale costs post March, in their responses SoLRs have made arguments as to why they should be able to recover these costs. As we set out in our original letter we remain open to this but consider that Ofgem needs to fully assess the merits of these arguments in light of market prices and the level of the price cap post-March which is as yet unknown. …
> …
>
> More generally on wholesale costs, as we set out in our original letter, we recognise that the current market conditions are highly uncertain and SoLRs may need to deviate from existing strategies for instance due to market liquidity. We also recognise that assumptions underpinning strategies (eg on volumes and churn) will be based on imperfect information. The criteria we set out in our original letter and copied below in annex 2 continues to be what we will use to assess wholesale costs; it is of the utmost importance that SoLRs provide full and clear explanations of their strategies and any deviations they felt were appropriate to make."

56. The criteria set out in annex 2 now read as follows:

> "Our main methodology criteria for assessing whether a SoLR levy claim is reasonable in all circumstances of the case 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.
• 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, nor would it be appropriate to allow **forecasted** wholesale 'shaping' costs given these have not yet been incurred.[3]
• 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 -[4] 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."

57. The underlining is mine, in order to highlight where additional text has been added to that in Annex 2 to the letter of 29 October 2021.

58. There was no objection or challenge to Ofgem's decision of 1 December 2021.

Adjustment of the price cap

59. In the meantime, in November 2021, Ofgem had consulted on adjusting the price cap to reflect the additional costs facing the industry. It published its decision on 4 February 2022. It decided to increase the cap significantly, with retrospective effect (in that costs incurred during Price Cap Period 7 Subject to would be recovered during the next two periods). The decision was long and detailed. It made it clear that the increase was intended to cover suppliers' increased shaping/imbalance costs.

The Deed of 1 March 2022

60. On 1 March 2022, E.ON and GEMA (acting by Ofgem) entered into a Deed of Undertaking in relation to E.ON's LRSP claims (the "Deed"). The recitals to

[3] My underlining
[4] My underlining

the Deed recorded the parties' agreement that E.ON required GEMA's consent to make a claim for any LRSP, pursuant to SLC 9.1 and 9.5; they also referred to the consultation and decision on the multi-stage claims process (referred to, respectively, as the "Open Letter" and the "LRSP Decision").

61. The Deed provided in relation to True-Up Claims, and how they would be treated, at cl. 5.3, as follows:

> "5.3 The Authority shall review each True-Up in accordance with this Deed and the criteria and approach set out in the Open Letter and the LRSP Decision (as may be amended or updated) and/or any replacement guidance issued."

62. This necessarily meant that True-Up claims would be reviewed as provided at SLC 9.1 and 9.5, in accordance with annex 2 to the decision of 1 December 2021 (as set out above), and/or any replacement guidance to be issued in the future.

Consultation on the approach to True-Up claims; Ofgem's decision

63. Having taken the decision to implement the multi-stage claims process, on 23 June 2022 Ofgem issued a consultation in relation to True-Up claims. It said, on the opening page:

> "The outcome of this consultation will determine what suppliers can seek to claim for in their final, true-up claim later this year."

64. The consultation document covered several different areas and kinds of costs, but among the costs on which Ofgem asked for consultees' views were shaping/imbalance costs. E.ON provided a response, as did others in the industry.

65. Ofgem published its decision on 21 September 2022 (albeit dated 15 September 2022). In relation to shaping/imbalance costs, it said:

> "3.14. Our approach to shaping and imbalance costs is consistent with our criteria for assessing whether a SoLR levy claim is reasonable, which 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.
> • 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 reasonable efforts to avoid the cost in the first instance or absorb the cost.
>
> 3.15. Suppliers are already receiving back payments throughout CP8 and CP9 to recoup the additional shaping and imbalance costs faced during CP7. To avoid overcompensating SoLRs through the levy, any SoLR seeking to claim for further incremental shaping and imbalance costs must demonstrate that the costs for their SoLR customers are more than those faced by their non-SoLR customers, for which they are already being compensated for through the price cap."

66. The text in paragraph 3.14 differed from the previous iteration of the Ofgem LRSP criteria (annexed to the 1 December 2021 decision on the multi-stage payment process) in that the text of the second bullet-point was somewhat abbreviated.

67. The text in paragraph 3.15 was new. This was because, while the criteria were, in essence, well established, it had not previously been necessary to apply them to shaping/imbalance costs. The decision set out Ofgem's view, following the consultation, as to how the now familiar criteria should be applied to shaping/imbalance costs.

68. There was no objection or challenge to Ofgem's decision of 21 September 2022 on its approach to True-Up claims.

E.ON's True-Up claim; Ofgem's Minded-to position; E.ON's response

69. E.ON submitted its True-Up claims for Igloo, Enstroga and Symbio in October 2022. They included substantial claims in respect of wholesale energy costs over Cap Period 7, totalling approximately £25.1 million. The claim in relation to Igloo was much the greatest (approximately £18.3 million). In each case, the wholesale costs included shaping/imbalance costs.

70. All three claims referred to E.ON's offer to make a contribution of £15 million for Igloo, quoting E.ON's email of 19:45 on 1 October 2021 and saying:

> "36. We will confirm our final level of contribution once Ofgem has assessed our claim and decided on the costs which will be approved.
>
> 37. Should any costs be rejected, we will make a judgement as to whether they have been reviewed fairly. If any have not, we will reduce our contribution accordingly."

71. Ofgem published a statement of its Minded-To position on each of these True-Up claims on 4 November 2022. In each case, the Minded-To position statement had a section headed 'Our true-up decision process and methodology', which referred to the decision of 21 September 2022 and set out the Ofgem LRSP 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.
> • **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."

72. This text is precisely the same as that set out in paragraph 3.14 of the decision of 21 September 2022.

73. Ofgem's Minded-To position included various substantial deductions from the True-Up claims made by E.ON in respect of wholesale energy costs. These were separated into various different elements, most of which were not contentious before me. In each case, the biggest deduction was in respect of shaping/imbalance costs: for Igloo the sum deducted was approximately £10 million.

74. In each case, the reasons given for the Minded-To deduction in respect of shaping/imbalance costs were as follows:

> "We note that elements of shaping and imbalance were included in the claim by E.ON Next. Ofgem clearly stated in our policy decision in September 2022 that, to avoid overcompensating SoLRs through the levy, any SoLR seeking to claim for further incremental shaping and imbalance costs must demonstrate that the costs for their SoLR customers are more than those faced by their non-SoLR customers.
>
> The information provided by E.ON Next shows shaping and imbalance costs above those accounted for by allowances in the cap. However, we have not seen any evidence in E.ON Next's response to demonstrate that the shaping and imbalance costs incurred in relation to its SoLR customers exceeded those of the remainder of its customer base (for example, our understanding is that E.ON Next has not provided shaping costs or a breakdown of forward compared to spot volumes/forecasts for its non-SoLR customers). This relates to our previously stated criteria for assessing claims as to whether the cost was directly incurred as part of their 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) and whether the SoLR had made all reasonable efforts to avoid the cost in the first instance or absorb the cost.

> Given this, in the absence of such evidence, we intend to deduct £10,053,195.09 from E.ON Next's claim for Igloo to reflect our estimate of the shaping/imbalance costs that we believe it has claimed for. We have calculated this amount by removing all 'short-term' trades (which we defined for this purpose as Day Ahead, Within Day and imbalance) carried out between November 2021 and March 2022 and the shaping and imbalance allowance is deducted from the revenue assumed to be recovered from customers instead."

75. On 30 November 2022, E.ON responded to Ofgem's Minded-To position documents, stating that it disagreed. In relation to shaping/imbalance costs, E.ON's letter stated:

> "… The additional shaping and imbalance costs have only been incurred as a result of an unmitigated increase in supply volume compounded by a volatile market. As a responsible supplier with a well-managed hedge position, E.ON would not have incurred these costs unless it had been appointed a SOLR for these failed suppliers.
>
> Since the RFI was issued, Ofgem has changed its view on the costs that can be recovered, and this leaves us with an unexpected shortfall in cost recovery. Ofgem has used its existing methodology criteria as a basis for deciding the costs that will or will not be approved. Although the criteria have been applied to claims from previous years, wholesale cost claims have only been a feature of levy claims relating to supplier failures from September 2021 onwards. Recent claims demonstrate that the criteria are not fit for purpose in all circumstances. Where suppliers are unable to recover reasonable costs through customer charges, there must be a means for suppliers to recover them elsewhere. If not, it must be made clear to suppliers when they receive the RFI requesting bids that certain costs cannot be recovered (so they can then be factored into their bids).
>
> We note that our claim for shaping and imbalance costs highlights a significant shortfall in the related price cap allowances with an impact into the hundreds of millions once scaled across our total SVT base. Ofgem must revise the allowances accordingly to ensure suppliers are fairly recompensed for their costs.
>
> Finally, when making our bids for Igloo, Symbio and Enstroga as part of the SoLR appointment process, we proposed by email a contribution of up to £15m towards the costs for Igloo. We made it clear that this proposed contribution was conditional on our claim being treated fairly. Should Ofgem maintain its position and continue to reject this element of our claim (£15,026,982.25); based on the reasoning set out above, our claim has not been treated fairly and, as a result, we will not be making any contribution."

76. Ofgem responded on 9 December 2022, not specifically addressing the deduction of shaping/imbalance costs but focussing instead on the indication that E.ON would not be making any contribution if the claim for shaping/imbalance costs were disallowed:

> "…we understand that E.ON Next proposes not to meet its commitment to absorb £15 million in wholesale costs incurred in respect of acting as SoLR for Igloo customers.
>
> This commitment was made by E.ON Next when Ofgem made the decision to appoint it to act as SoLR for Igloo customers. No condition about fair treatment of LRSP claims by E.ON Next could meaningfully modify that commitment as Ofgem has a statutory duty to act fairly and reasonably in exercising its discretion to consent to any LRSP claim. In reaching our minded-to position on the E.ON Next claim for LRSP in respect of its SoLR role for Igloo, Ofgem has taken into account the statutory framework, all the relevant circumstances and no irrelevant factors, as required in reaching a fair and reasonable decision.
>
> Under the supply licence Standard Licence Condition (SLC) 8.3 a supplier is required to take all reasonable steps to honour any commitment made to Ofgem before being appointed to act as SoLR. We are therefore notifying you that we consider that, to meet the commitment made when bidding for appointment, E.ON is required to absorb £15 million of the additional wholesale costs it incurred in acting as SoLR for Igloo customers.
>
> Ofgem will take into consideration the responses to our consultation on our minded-to position published 4 November 2022 and reach a decision on the amount that E.ON Next could claim for the additional costs, including additional wholesale costs, incurred in acting as SoLR for Igloo customers. Ofgem is minded to reduce that amount by £15 million in determining the amount we consent to E.ON Next claiming as LRSP. The reason for this is that we consider that E.ON made a commitment when bidding for appointment as SoLR to absorb £15 million of the additional wholesale costs incurred in acting as SoLR."

77. E.ON replied on 12 December 2022, referring to the previous correspondence (including E.ON's letter of 30 November 2022), as follows:

> "… we do not agree with Ofgem's minded-to position to disallow our claims for shaping and imbalance costs from November 2021-March 2022.
>
> After the SoLR RFI was issued, Ofgem acted unreasonably and changed its view on the costs that can be recovered, and this leaves us with an

unexpected shortfall. After we were appointed (on the basis of the offer made at 19.45 on 1 October 2021), Ofgem subsequently applied a retrospective methodology criteria which failed to recognise the importance and implications of wholesale costs in these levy claims.

Where SoLRs are unable to recover reasonable costs through customer charges, if Ofgem decides these cannot be claimed for via the SoLR levy, this must be made clear to can then factor this into their bids). For avoidance of doubt this was not made clear in the SoLR RFIs for Igloo, Symbio or Enstroga. We note that our claims for shaping and imbalance costs highlight a significant shortfall in the related price cap allowances with a significant impact when scaled across our total SVT customer base. Ofgem should revise these allowances accordingly; however, until this happens, as these costs relate directly to a supplier acting as SoLR, it seems reasonable for them to be treated as a cost within a SoLR claim.

The shaping and imbalance costs we included in our claim have only been incurred as a direct result of an increase in supply volume from SoLR customers compounded by a volatile wholesale market. We have been transparent in evidencing that these costs have been incurred in a reasonable manner. E.ON would not have incurred these costs if it had not been appointed a SoLR for these failed suppliers. These costs are not inconsistent with the guidance in place at the time E.ON was appointed as SoLR.

For the avoidance of doubt, we believe that our levy claim should be honoured in full and that there is no basis for Ofgem to withhold the £15.026m for shaping and imbalance. Given that Ofgem intends to reject this element of our claim we continue to believe that we have been treated unfairly and as a result we will not be making a contribution of £15m towards the wholesale or other costs for Igloo, Symbio or Enstroga. We therefore do not accept and do not see a basis upon which Ofgem can reduce our claim for acting as SoLR for Igloo customers by £15m, as set out in your letter of 9 December."

78. Although this letter referred back to E.ON's letter of 30 November 2022, and although the ultimate stance adopted was the same as in that letter, there was an important difference in E.ON's reasoning.

i) In the letter of 30 November 2022, E.ON expressly accepted that the methodology/criteria Ofgem had used for its Minded-To positions was the same as before ("… Ofgem has used its existing methodology criteria…"), but said that those criteria were "not fit for purpose" in relation to wholesale cost claims.

ii) Now, E.ON explained its complaint on the basis that Ofgem had "… changed its view on the costs that can be recovered…" and had "…subsequently applied a retrospective methodology criteria…"

The Decisions of 20 December 2022

79. In all three Decisions, E.ON maintained its deduction in respect of shaping/imbalance costs; and, in relation to Igloo, it also deducted a further £15 million because of E.ON's refusal to make a contribution.

80. In the Decisions, Ofgem commented on the suggestion that it had changed its approach, as follows:

> "*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."

81. Ofgem also commented on the effect of its decision on suppliers being willing to volunteer as SOLRs in the future:

> "*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·
>
> > '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.'[5]
>
> 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."

82. Ofgem commented on the status of supplier's' RFI responses and whether an appointment by Ofgem is an endorsement of requests made by suppliers in such responses:

> "*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

[5] This was a quotation from the judgment of Thornton J in *ScottishPower* at [97]

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."

83. Finally, Ofgem explained the reasons for its decision on shaping/imbalance costs as follows:

"Reasons for decision
We have decided to disallow the part of E.ON Next's claim that we estimate to relate to shaping and imbalance costs. This is because no evidence has been provided by E.ON Next to demonstrate the costs for its SoLR customers were more than those faced by its non-SoLR customers. In particular, E.ON Next's claim for these costs conflicts with the criteria set out above that costs being claimed for must be as a result of taking on customers in an emergency situation as opposed to normal customer acquisition routes; and that the costs being claimed should be additional to those of existing customers.

In relation to E.ON Next's expectations at the time of responding to the RFI issued to suppliers as part of the SoLR process, we note that 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.

We do not agree with E.ON Next's submission that these criteria are not fit for purpose – instead, we consider that they are crucial to ensure that claims are consistent with the requirements of the licence condition, and that consumers' interests are protected.

Finally, we note that a commitment to contribute £15m towards the cost of Igloo was made by E.ON Next when we made the decision to appoint it to act as SoLR for Igloo customers. No condition about fair treatment of LRSP claims by E.ON Next could meaningfully modify that commitment as Ofgem has a statutory duty to act fairly and reasonably in exercising its discretion to consent to any LRSP claim. In reaching our final position on the E.ON Next claim for a LRSP in respect of its SoLR role for Igloo, Ofgem has taken into account the statutory framework, all the relevant

> circumstances and no irrelevant factors, as required in reaching a fair and reasonable decision.
>
> Under the supply licence Standard Licence Condition (SLC) 8.3 a supplier is required to take all reasonable steps to honour any commitment made to Ofgem before being appointed to act as SoLR.
>
> In the letter provided to Ofgem on 12 December, E.ON Next made representations to Ofgem regarding why we should not deduct the £15million from the E.ON Next claim. Nothing raised in that letter addresses new issues, and restates E.ON Next's position with respect to the treatment of wholesale costs in particular through the True Up process.
>
> Ofgem has decided to reduce by £15 million the amount we consent to E.ON Next claiming as LRSP. The reason for this is that we consider that E.ON made a commitment when responding to our RFI to absorb £15 million of the additional wholesale costs incurred in acting as SoLR."

84. I should explain that the text in the last three paragraphs set out above – from "Finally, we note that…" onwards – only appears in the Decision relating to Igloo. That is because it was only in respect of Igloo customers that E.ON had offered to contribute £15 million (albeit this offer was expressed to be subject to Ofgem's treatment of E.ON's LRSP claims in respect of all of Igloo, Symbio and Enstroga – per E.ON's email at 19:45 on 1 October 2021).

E.ON's grounds; GEMA's case in response

85. By the time the hearing commenced, E.ON relied on three grounds (one of its original grounds having been abandoned).

86. E.ON's primary ground was that the Comfort Letter created a legitimate expectation that the claim would be allowed by Ofgem, insofar as it related to shaping/imbalance costs.

87. E.ON's second ground was that the Decisions were irrational.

88. E.ON's third ground – which it ran only as an alternative to the first two, i.e. it would only be relevant if they both were to fail – was that, in the circumstances, it was entitled not to make a contribution of £15 million in relation to Igloo customers; therefore the Igloo Decision was flawed in that it wrongly reduced the amount of E.ON's claim for Igloo on this account.

89. GEMA's response on the first ground was that the Comfort Letter had not created a legitimate expectation; but, even if it had, this must have been undone by the Deed.

90. GEMA's response on the second ground was that the Decisions were not irrational; they were a reasonable application of well-established criteria; the discretion given to GEMA/Ofgem under SLC 9.5 was broad; Ofgem must be allowed a wide margin of appreciation.

91. GEMA's response on the third ground was to rely on SLC 8.3. E.ON had made a commitment and was obliged to honour it.

The legal principles re 'legitimate expectation'

92. There was no dispute about the relevant legal principles. For a party to be entitled to rely on a legitimate expectation, the statement said to give rise to the legitimate expectation must have been "clear, unambiguous and devoid of relevant qualification": *R v IRC, ex parte MFK Underwriting* [1990] 1 WLR 1545, per Bingham LJ at p. 1569 G-H. The Court must approach this objectively and is not concerned with the subjective understanding of the party seeking to rely on the alleged legitimate expectation: *Anand and another (as trustees of the Central Gurdwara (British Isles) London Khalsa Jatha) v Royal Borough of*

Kensington and Chelsea [2019] EWHC 2964 (Admin), per Lang J at [67]. In doing so, the Court will have regard to the context: *R (Association of British Civilian Internees: Far East Region) v Secretary of State for Defence* [2003] QB 1397, per the Court of Appeal at [60] and [62]-[67].

93. It was not disputed that the context relevant to construing the Comfort Letter included the provisions of SLC9, the RFI, E.ON's response to the RFI and the further exchanges that led up to the Comfort Letter.

E.ON's case as to the content of the legitimate expectation

94. In its Statement of Facts and Grounds, E.ON's case as to the legitimate expectation created by the Comfort Letter was set out as follows (in paragraph 72):

> "Ofgem gave the clearest possible confirmation that the Claimant would be entitled to recover such reasonable, additional, wholesale costs (including shaping and balancing) as were directly caused by (i.e. would not have otherwise arisen but for) the SoLR appointments."

95. This suggested that E.ON's case as to the legitimate expectation was that the only criterion that would applied was a 'but for' test – i.e., whether the shaping/imbalance costs would not have been incurred, but for the SoLR appointment. I note, however, that this pleaded formulation appears to accept that such costs must be "reasonable"; which implies that Ofgem would still be able to exclude costs that it considered unreasonable.

96. In its skeleton argument for the hearing and in Mr Sinclair's oral submissions, E.ON expanded on this by saying that Ofgem's approach in the Decisions was that E.ON had to establish that the shaping/imbalance costs for SoLR customers were higher than those for other customers; and this was a new test, introduced

after the Comfort Letter and the legitimate expectation to which it gave rise. I understood from this that E.ON's case was that the Comfort Letter gave rise to a legitimate expectation that E.ON's claim for shaping/imbalance costs would not be assessed by reference to any criteria not apparent from the Comfort Letter itself (and the relevant context), and that the alleged new test – whether shaping/imbalance costs for SoLR customers were higher than those for other customers – was not such a criterion.

97. Mr Sinclair said that E.ON was not advancing a case that a claim for shaping/imbalance costs must be accepted by Ofgem without any scrutiny at all. I found it difficult to follow precisely what kind of scrutiny was said to be permitted, and what was not. Ultimately, Mr Sinclair explained E.ON's case on the basis that Ofgem could carry out arithmetical checks pursuant to SLC 9.6, but there would be no scope for shaping/imbalance cost claims to be disallowed by the exercise of the broad discretion under SLC 9.5.

Analysis of E.ON's case as to the alleged legitimate expectation

98. In its original response to the RFI, E.ON stressed the importance of being able to recover wholesale costs, including shaping/imbalance costs. However, the word "recover" was replaced, at Ofgem's insistence, by the word "claim"; and Ofgem made it clear in the Comfort Letter that, while E.ON was likely to submit a claim for such costs, this claim would be subject to Ofgem's review: "…any subsequent claim for costs incurred within the categories outlined is subject to Ofgem's review."

99. I see nothing in the Comfort Letter that limited the nature or scope of this review. For the Comfort Letter to have restricted, fettered or ousted Ofgem's

discretion under SLC 9.5 would have required direct language, so as to be "clear and unambiguous". The Comfort Letter contained nothing of this kind. It did not restrict, fetter or oust Ofgem's discretion under SLC 9.5.

100. On the contrary, SLC 9.5 is at the heart of the normal review process, being the source of Ofgem's power to "decide on a case-by-case basis whether it might be appropriate for a SoLR to make a claim on the levy", by considering "whether the amount of any claim or the reasons for any claim were reasonable" – cf. paragraph 2.27 of Ofgem's 2016 Guidance, which was expressly referenced in the FAQ annex to the RFI. On a natural reading, the Comfort Letter was making it clear that any claim would be subject to that normal review process.

101. It follows that the Comfort Letter did not give rise to a legitimate expectation that E.ON's LRSP claim would not be subject to SLC 9.5. On the contrary, it made it clear that it would, and that Ofgem would consider whether the claim was reasonable, in its view.

102. The Comfort Letter said nothing about the criteria or tests that would be used by Ofgem when reviewing the LRSP claim, let alone anything "clear and unambiguous". Once again, therefore, there is nothing in the language of the Comfort Letter that could have given rise to a legitimate expectation that the review under SLC 9.5, or Ofgem's assessment of reasonableness, would be conducted without reference to whether the shaping/imbalance costs for SoLR customers were higher than those for other customers.

103. Direct language of that kind would have been particularly necessary in circumstances where Ofgem had published its criteria many times, in the

context of previous consultations and decisions, and on every occasion they had included the following:

> "• **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."

104. It must have been obvious to E.ON that the review that was anticipated in the Comfort Letter would, or at least might, involve Ofgem applying this criterion (along with others) – either with or without the additional sentence that appears to have been used on all occasions prior to E.ON's appointment as SoLR[6]. I certainly do not see how E.ON could reasonably or legitimately have expected Ofgem not to apply it. Yet, this is the basis on which Ofgem decided to refuse E.ON's shaping/imbalance costs:

> "… no evidence has been provided by E.ON Next to demonstrate the costs for its SoLR customers were more than those faced by its non-SoLR customers. In particular, E.ON Next's claim for these costs conflicts with the criteria set out above that costs being claimed for must be as a result of taking on customers in an emergency situation as opposed to normal customer acquisition routes; and that the costs being claimed should be additional to those of existing customers."

105. It is also notable that E.ON did not object to this criterion (or any of the others) when told that Ofgem would assess LRSP claims on this basis in the consultation on the multi-stage process, the decision of 1 December 2021, the consultation on the approach to True-Up claims and the decision of 21 September 2022.

[6] "It would not be appropriate for us to allow the SoLR to claim for costs they would have incurred through a normal acquisition route". This additional sentence also featured in the version of this bullet-point annexed to the consultation on the multi-stage process and E.ON's decision of 1 December 2021.

The Deed

106. Ms Simor KC submitted that, even if the Comfort Letter had given rise to the legitimate expectation for which E.ON contended, it was not open to E.ON to rely on that legitimate expectation, following its entry into the Deed of 1 March 2022.

107. Mr Sinclair accepted that this would be so if the Deed were inconsistent with reliance on the legitimate expectation, but he said that there was no inconsistency.

108. The recitals to the Deed and its clause 5.3 are conclusively against Mr Sinclair on this. By becoming party to the Deed, E.ON expressly agreed that it required GEMA's consent to make a claim for any LRSP; that GEMA's power to give (or withhold) such consent arose pursuant to SLC 9.1 and 9.5; that GEMA (i.e., Ofgem) would therefore review any LRSP claim; and that it would do so by reference to the criteria set out in annex 2 to the decision of 1 December 2021.

109. This is fatal to E.ON's case in so far as it is based on legitimate expectation. Neither Ms Simor KC nor Mr Sinclair explored the analytical basis on which this must be so, but I have no doubt of the result. One possible analysis is that the Deed means that E.ON is estopped from relying on the Comfort Letter or any legitimate expectation arising out of it, insofar as inconsistent with the Deed.

Conclusion on the 'legitimate expectation' ground

110. E.ON's case on 'legitimate expectation' fails. The terms of the Comfort Letter, objectively understood in the relevant context, did not give rise to the legitimate

expectation contended for by E.ON (especially bearing in mind the requirement of a "clear and unambiguous" statement). Moreover, even if the Comfort Letter had been capable of giving rise to the alleged legitimate expectation, this case would still have failed, because of the clear terms of the Deed.

The legal principles re 'irrationality'

111. This Court must apply a wide margin of appreciation, having regard to GEMA's role as an expert regulator and applying the standard of review set out in *R v Director General of Telecommunications ex p Cellcom* [1999] ECC 314 at [26]:

> "Where the Act has conferred the decision-making function on the Director, it is for him, and him alone, to consider the economic arguments, weigh the compelling considerations and arrive at a judgment… so long as he directs himself correctly in law, his decision can only be challenged on Wednesbury grounds. The court must be astute to avoid the danger of substituting its views for the decision-maker and of contradicting (as in this case) a conscientious decision-maker acting in good faith with knowledge of all the facts."

112. As Thornton J noted n R v *ScottishPower* at [97], in reaching decisions on whether to allow LRSP claims to be made, the Authority:

> "…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, including the future role of a Supplier of Last Resort within the market and the potentially distorting effects of allowing a supplier to claim…. It is a decision that affects the entire industry and the operation of the market in the future. In particular, Ofgem must balance the need to ensure that its approach to claims for a LRSP ensures that suppliers are not disincentivised from bidding to become SoLRs, whilst not creating a moral hazard, namely circumstances where suppliers under-bid or take excessive risks bidding, 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."

E.ON's case that the Decisions were irrational

113. As explained in its skeleton argument and in Mr Sinclair's oral submissions, E.ON's case on irrationality overlapped with the case on 'legitimate expectation', in that E.ON again asserted that the Decisions were arrived at on the basis of a new criterion – i.e., whether shaping/imbalance costs for SoLR customers were higher than those for other customers. E.ON then asserted that this criterion was impossible to meet, because shaping/imbalance costs would inevitably be the same for all the customers of any supplier. Taking on new customers, especially suddenly and as a SoLR, would be likely to result in additional and unexpected shaping/imbalance costs, but they would be met by the entirety of the customer base; they would not be attributable only to the new SoLR customers.

Analysis of E.ON's case as to irrationality

114. I have already noted that, when in its response of 30 November 2022 to Ofgem's Minded-To position documents, E.ON expressly accepted that the methodology/criteria Ofgem had used for its Minded-To positions was the same as before ("… Ofgem has used its existing methodology criteria…"), but said that those criteria were "not fit for purpose" in relation to wholesale cost claims; and that the suggestion that Ofgem was using a new criterion was made for the first time in E.ON's reply of 12 December 2022.

115. In my view, E.ON's response of 30 November 2022 was correct to acknowledge that the reason given by Ofgem for excluding the shaping/imbalance costs was one that reflected Ofgem's existing criteria.

i) In the Minded-To positions, the reason was said to be that "we have not seen any evidence in E.ON Next's response to demonstrate that the shaping and imbalance costs incurred in relation to its SoLR customers exceeded those of the remainder of its customer base."

ii) In the Decisions, it was said to be that "no evidence has been provided by E.ON Next to demonstrate the costs for its SoLR customers were more than those faced by its non-SoLR customers."

iii) There is no material difference between these formulations. They both reflect the second of the bullet-point criteria, which had been set out many times both before and after E.ON's appointment, without objection, in substantially the same terms:

> "• **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"

iv) Paragraph 3.15 of Ofgem's decision of 21 September 2022 on the approach to True-Up claims explained how Ofgem would apply this familiar criterion to claims for shaping/imbalance costs: to recover such costs, the SoLR "must demonstrate that the costs for their SoLR customers are more than those faced by their non-SoLR customers, for which they are already being compensated for through the price cap".

116. It follows that the objection that this was a new criterion, rather than a familiar criterion being applied in a new context, is wrong.

117. As to the argument in E.ON's response of 30 November 2022 that the familiar criterion was "not fit for purpose" in relation to this new context, that point had

already been answered by Ofgem in the very passage just quoted from paragraph 3.15 of Ofgem's decision of 21 September 2022. It was fit for purpose (or could rationally be so considered), because the retrospective increase in the price cap for Cap Period 7 had been expressly intended to cover supplier's increased shaping/imbalance costs, as set out in Ofgem's decision of 4 February 2022.

118. In any event, the identification and selection of suitable criteria is within the margin of appreciation that GEMA and Ofgem are to be allowed. The decision stated that this criterion, along with the others, was "crucial to ensure that claims are consistent with the requirements of the licence condition, and that consumers' interests are protected." This indicates that, in selecting its criteria, Ofgem had acted with regard to the relevant statutory objectives. This cannot properly be criticised.

119. Furthermore, although E.ON asserted that the criterion was impossible to meet, Ms Simor KC correctly pointed out that, while this may have been true for E.ON, no evidence was presented either to Ofgem or to me that it must also have been true for all other suppliers.

Conclusion on the 'irrationality' ground

120. The 'irrationality' ground also fails. Ofgem had explained its approach to shaping/imbalance costs in advance, in the decision of 21 September 2022, and then again in its Minded-To positions, as well as in the Decisions themselves. On each occasion, the reasons given were clear and coherent.

121. The fact that these reasons were also consistent with the Deed (which, as noted, referred back to the criteria set out in annex 2 to the decision of 1 December 2021) is, again, a further problem for E.ON: it is not open to E.ON to say that the application of those criteria (including the second bullet-point) is inappropriate.

E.ON's alternative ground: GEMA/Ofgem wrong to deduct £15 million

122. E.ON's alternative ground proceeded on the basis that its offer to contribute £15 million had been subject to the express reservation "at our discretion, to reduce our contribution if any of our claims for wholesale or other costs are in our opinion treated unfairly." E.ON said that the words "at our discretion" and "in our opinion" must be given their natural meaning, and that it followed that the offer to contribute was not a "commitment" within the meaning of SLC 8.3; alternatively, any commitment was subject to this reservation.

123. E.ON relied on evidence from its Head of Regulation, Mr Stephen Davies, who confirmed that, in E.ON's opinion, Ofgem's decision to exclude all shaping/imbalance costs was unfair, and E.ON had accordingly exercised its discretion against making a contribution. Mr Sinclair submitted that E.ON therefore was not acting inconsistently with any commitment when it responded to the Minded-To positions by stating, in its message of 30 November 2022, that it would not be making any contribution because its claim had not been treated fairly. Ofgem had therefore acted wrongly, and irrationally, when it decided to reduce the LRSP claim in relation to Igloo by £15 million, in response to E.ON's announcement that it would not make any contribution.

124. GEMA's answer to this was that E.ON's offer to contribute £15 million would be worthless, and not a proper commitment, if it were subject to E.ON's unqualified discretion. Ms Simor KC said that, as a matter of construction, the offer therefore should be understood as meaning that the contribution would stand unless (i) GEMA/Ofgem failed to act fairly as required under the statutory framework (i.e., in effect, they acted in a way that could be challenged by judicial review) or (ii) E.ON's opinion that its claim had been treated unfairly was based on reasonable grounds. She also said that, by offering to contribute £15 million, E.ON had waived its ability to make a LRSP claim to the extent of £15 million.

Analysis in relation to the deduction of £15 million from the Igloo LRSP claim

125. In its response to the Igloo RFI, in its 1 October 2021 response to the follow-up questions on the contribution and in its message of 19:45 on that day (increasing the contribution to £15 million), E.ON always made it clear that the offer to make a contribution was subject to its reservation of the right to reduce the contribution.

126. Ofgem clearly understood the significance of this from the outset, hence its first follow-up question of 1 October 2021:

> "Please could you provide more detail on the circumstances in which you would provide the £10m contribution to wholesale costs for Igloo? What circumstances would have to be met for EON to provide the full £10m contribution? Under what circumstances would this contribution be reduced to £0?"

127. The terms of this question are important. They acknowledge the possibility that, in some circumstances, there will be no contribution.

128. The answer to Ofgem's question – echoed in the subsequent message of 19:45 – was in the terms already set out, i.e. that the circumstances in which this might happen would depend on E.ON's opinion and E.ON's discretion.

129. In the contractual context, where one party reserves something to the exercise of its own discretion, the court will generally ensure that the discretion is not abused by implying a term that it must be exercised rationally: *Braganza v BP Shipping Ltd* [2015] 1 WLR 1661. However, as Ms Simor KC rightly stressed, the exchanges that preceded E.ON's appointment did not give rise to a contract. There is, therefore, no scope to gloss the words actually used by E.ON by importing extra words via the doctrine of implied terms.

130. E.ON was under no obligation to make any contribution unless it offered to do so. The essential question is whether E.ON's response to the RFI and its other messages on 1 October 2021 constituted a commitment within SLC 8.3 – or, possibly, a partial waiver of the right to make a LRSP claim. In my judgment, what E.ON said must simply be taken at face value. E.ON insisted on the right to form its own opinion as to whether GEMA/Ofgem treated its LRSP claims fairly, and to exercise its own discretion. The words used by E.ON in the relevant communications did not qualify or limit the opinion/discretion in any way. They meant that E.ON had not in fact committed to making any contribution at all.

131. GEMA's objection that an offer that is subject to an unqualified discretion is worthless and not a true commitment is entirely correct. But that is the only offer that E.ON made. GEMA appears to have valued E.ON's offer at £15

million, and made a deduction accordingly in the Igloo Decision. However, the reality is that E.ON's offer was simply undependable.

132. To put this another way, in so far as E.ON made a 'commitment', it was to make a contribution of £15 million if, but only if, it formed the opinion that its LRSP claims were being treated fairly.[7] Understood in this way, and in circumstances where E.ON in fact formed the opinion that its LRSP claims were not treated fairly, E.ON has honoured its commitment.

133. Either way, E.ON did not act inconsistently with its obligations under SLC 8.3, and the reason Ofgem gave for making a deduction of £15 million is wrong in law and/or the deduction was legally irrational.

Conclusion on the deduction of £15 million from the Igloo LRSP claim

134. E.ON's alternative ground of challenge therefore succeeds, in respect of the deduction of £15 million from the Igloo LRSP claim.

[7] Along with some other, irrelevant conditions.