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Flexible and Responsive Energy Retail Markets

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, storage, and energy supply to end users. We have around five million electricity and gas customer accounts in the UK, including residential and business users.

The energy system is going through a significant transition as the sector decarbonises and emerging technologies and new energy services develop across the sector. Energy consumers will undoubtedly need to play an increasingly active role in this transition as the UK works towards achieving its net zero targets by 2050. In this context, we are therefore supportive of this joint review of the retail market framework, which should establish what opportunities exist for changes that will further enable the energy transition, ensuring that the retail market will continue to deliver fair outcomes for all consumers while supporting the innovation and investment that will be needed to achieve net zero.

Overall, EDF Energy is supportive of the Government's proposed market vision and the outcomes being sought. To deliver this vision, it is important that the regulatory framework facilitates an effective and thriving competitive market that facilitates new entry, innovation, and investment and enables efficient and responsible market participants to be sustainable in the long term. A well-functioning competitive market, with minimal distortions, will deliver the best outcomes for customers, including fair prices. We recognise, however, that customers who are unable to engage with the market due to their vulnerable circumstances, which increases their risk of being in fuel poverty, are likely to require some form of targeted protection following the ending of the current price caps.

The review rightly has a focus on the extent to which market is working for default customers. It should also undertake a more holistic review of the market, including whether more active sectors of the market are functioning in a manner that best meets consumer interests. The combination of a price cap together with a market floor which at times does not, in our estimation, cover the marginal costs of supply, does not represent a healthy sustainable market. This review, together with Ofgem's effective competition assessment (as required under the Default Price Cap legislation), is an opportunity to assess the financeability of the sector and the potential consequences for competition and consumers.

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When a supplier fails and exits the market this can be disruptive to their current (and previous) customers, lead to additional mutualised costs and undermine trust in the sector. There is a clear need for more effective ongoing regulatory monitoring of the financial resilience of all suppliers in order to minimise the costs and detriment that result from such failures. In addition to this monitoring, changes are required to ensure all suppliers bear an appropriate share of the risk they impose on the system. Firstly, BEIS should investigate whether proportionate and sustainable risk based credit cover arrangements could be established for the RO, FiT and Warm Home Discount schemes in order to minimise the need for mutualisation when shortfalls arise. Secondly, alternative measures are required to better protect customer credit balances at times of failure, without the need for mutualising such costs through use of the industry levy. This could include a requirement for suppliers that cannot demonstrate robust levels of creditworthiness to provide some form of surety.

There are certain customer types which impose a higher cost to serve on suppliers and that the distribution of these customers is more geared to large legacy suppliers. For example, deemed contract customers typically represent a higher debt risk than other domestic customers, imposing higher debt collection and bad debt costs. We consider these are genuine additional costs which cannot be explained by inefficiencies in operating costs. We are therefore supportive of exploring potential measures which aim to remove any consequential distortions to competition that arise.

It is right to maintain aspects of the current energy market framework that work well for customers. The proposal to take a phased approach to market reform by keeping aspects of the current arrangements in place for the medium term, including a continuation of the policy that energy suppliers are to hold a licence and consumers are to use a supplier, is the right approach.

The regulatory framework needs to enable innovation and choices for consumers, while at the same time ensuring consumers enjoy consistent protection (across all energy choices). We therefore fully support proposals to directly regulate third party service providers who undertake energy related customer facing activities.

The unbalanced burden, in terms of tax and policy costs, of electricity and gas is a significant barrier to energy efficiency investment and decarbonisation. This cost imbalance does not encourage the electrification of heat and does not facilitate a shift to low carbon heat sources being installed at a rate comparable to what is required in order to achieve net zero by 2050. Government must consider interventions that make the electrification of heat cost-effective for the consumer.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Steven Eyre, or myself.

Yours sincerely,

R. Beresford

Rebecca Beresford
Head of Customers Policy and Regulation

cc. Future Retail Market Design Team, Ofgem

Attachment

Flexible and Responsive Energy Retail Markets

EDF Energy's response to your questions

1. Do you agree with our vision for the future of the energy retail market, the outcomes we are seeking to achieve and our characterisation of the key challenges we need to overcome?

The energy system is going through a significant transition as the sector decarbonises and emerging technologies and new energy services develop across the sector. There is a clear need for energy consumers to play an increasingly active role in this transition as the UK work towards achieving its net zero targets by 2050. In this context, it is right therefore for BEIS and Ofgem to conduct a joint review of the retail market framework which should consider what opportunities exist for changes that will further enable the energy transition, ensuring that the retail market will continue to deliver fair outcomes for all consumers, while supporting the innovation and investment that will be needed to achieve net zero.

EDF Energy wants to play a key role in this transition and is finding innovative ways to support the move to a smarter, more flexible energy system. Although energy suppliers can play a leading role, additional support from wider industry and Government will be required to facilitate the path to 2050. We are therefore supportive of the Government taking a joined up approach to the reforms being considered under the various workstreams.

In principle, we are supportive of the proposed vision and the outcomes being sought. EDF Energy remains convinced that healthy and robust competition with minimal distortions is the best way to serve customers' needs over the longer term. As acknowledged by Ofgem in a recent discussion paper[1], a well-functioning competitive market includes the ability for efficient suppliers to be able to finance their activities. An effective and thriving competitive market, delivering in the best interests of consumers and which facilitates new entry and investment, requires business models to be sustainable in the long term.

Customer engagement will remain an important issue for the market, both in achieving decarbonisation objectives, and also in ensuring the success of the competitive market in delivering fair prices for all. We therefore welcome the continuing work by both Ofgem and Government to promote customer engagement, including to ensure that customers find it easy to compare and switch between tariffs and suppliers. We recognise, however, that customers who are unable to engage with the market due to their vulnerable circumstances, which increases their risk of being in fuel poverty, are likely to require some form of protection following the ending of the current price caps.

If further protection for some customers is going to be required in a post cap environment, then this should be made clear as early as possible, in order to avoid the unnecessary introduction of other competing measures designed to deliver similar consumer outcomes. Furthermore, to ensure any such protection is implemented fairly, it is essential that the scope of protection is clearly set by Government and achieved via appropriate data sharing.

[1] Ofgem Discussion Paper – Developing a framework for assessing whether conditions are in place for effective competition in domestic supply contracts

We note that the vision set out is very much price centric and does not reflect other factors that are important and valuable to customers, such as quality of service (especially those in vulnerable circumstances) or low carbon energy. Low prices do not necessarily coincide with good outcomes, and can reflect poor quality of service, limited choice, and unsustainable pricing behaviour. Furthermore, some customers may in fact be willing to pay for different levels of service including, for example, telephone access to customer services.

For consumers to actively engage in the decarbonisation agenda it is vitally important that they have full transparency as to the true carbon content of their consumption. The current regulatory framework for 'Green Tariffs' does not meet this objective and can result in consumers being misled as to the environmental impact of their energy choices.

We believe that it is important that any reforms take due consideration of these additional factors.

2. Are there examples of new products, services and business models that would benefit current and future consumers, but are blocked by the current regulatory framework?

We agree that unnecessary barriers to beneficial innovation should be removed, yet at the same time it is important that irrespective of how consumers engage with the market that they continue to receive effective consumer protection and a fair standard of service. There will therefore be a need for the regulatory framework to keep a pace with innovation and the entry of new energy service providers. In particular, there is a need to establish a level regulatory playing field in order to ensure consumers continue to receive consistent protection across all their energy choices.

Although the energy supply market is experiencing high levels of new entry, there is a question mark regarding the quality of some of these new competitors, and the sustainability of their business models. While we welcome new entrants that compete through innovation in customer propositions, and through new ways of working, a market that includes companies with unsustainable business models, or innovations that are simply based on cost avoidance, undermines effective and fair competition, damages consumer trust, and risks real consumer detriment. Consequently, we consider there is a balance to be struck between minimising undue barriers of entry and ensuring that new entrants are suitably prepared, resourced and fit to operate in the market.

Prior to the recent changes made by Ofgem as part of its Supplier Licensing Review, we believe the licensing approach arguably over focussed on the former and has in some cases led to ill prepared entities entering the market to the detriment of customers and the market as a whole. We are therefore supportive of Ofgem's move to implement better checks on new entrants and in particular on applicant's funding arrangements.

While Ofgem strengthening its market entry approach is very much welcome, material risks to consumers and participants arise when suppliers are of a material scale. This suggests that the regulatory arrangements for ongoing oversight and financial resilience are at least as, if not more, important than those which apply at the licensing stage.

The events of 2018 clearly demonstrated this. A string of supplier failures, together with a number of defaulting suppliers has, for the first time, resulted in shortfall levels for the Renewables Obligation (RO) and Feed in Tariff (FiT) schemes being sufficient to trigger mutualisation. This results in suppliers with more robust business models and funding arrangements, and in turn the customers of these suppliers, having to cover the costs of higher risk ventures. We believe this is deeply unsatisfactory and must change. We look forward to continuing to work with Ofgem to develop ongoing arrangements that deliver on the primary objective of ensuring that each individual supplier bears the costs of the risk they impose on the system.

Smart Data has the potential to deliver benefits to consumers, including those who may be in a vulnerable circumstance. Providing consumers with easy access to their data, and enabling them to share it could ensure they have access to products and services better suited to their needs. It is important that the data access framework and controls, while appropriately protecting customers interests (including by having a suitable consent framework), does not act as a barrier to the delivery of wider energy system benefits. We note that there are a wide range of data initiatives underway that are likely to have an impact on the retail market, such as Midata, The Energy Data Taskforce, Smart Metering and Settlement reform. There is a clear need for this review to coordinate with the ongoing development of these initiatives in order to avoid introducing further reforms that may, for example, undermine this wider work or lead to unnecessary costs being incurred.

We are pleased to see acknowledgement of industry's efforts to remove potential barriers to innovation where these sit within the industry code arrangements. EDF Energy is supportive of code changes being developed which are designed to facilitate the development of beneficial consumer innovation. We welcome the current review of the industry code governance arrangements. We look forward to actively engaging in the review with a view to seeking changes that better enable the transition towards a more flexible energy system with net zero emissions, while minimising costs and protecting consumers.

Where current regulations may present a challenge for businesses looking at launching new products, services or business models, Ofgem's Innovation Link provides opportunities to trial projects by working closely with Ofgem to ensure this is implemented in a way that is aligned with the regulator's priorities and where consumers are adequately protected. EDF Energy is part of a consortium which is one of the first to take advantage of the opportunities provided by the Innovation Link, by trialling a pioneering energy trading project (P2P) that enables customers to trade solar energy with each other. This collaborative approach allows EDF Energy to focus on maximising the potential benefits for customers whilst providing feedback to Ofgem so that we can determine whether any changes are needed to the regulatory environment to allow the business model to bring benefits to a much greater number of customers.

3. Are there current or emerging harms to energy consumers which are currently out of scope of the regulatory framework? Do these differ for domestic and non-domestic consumers?

Energy suppliers face significant obligations by virtue of their licensed status. In an evolving energy market where new parties are looking to enter the market and offer a variety of services to consumers, there is a risk that such parties will not be subject to similar obligations, or even appropriate consumer protection regulation specific to the activities they undertake. This to a certain extent is already happening with third party intermediaries (TPIs), such as price comparison websites and those operating in the business sector, undertaking customer facing marketing activities but who are not subject to direct regulation, instead at times regulated indirectly by being treated as a 'representative' of a licensed supplier.

In an evolving market place, we do not consider that customers' interests are best protected through indirect regulation of parties. It is essential that consumers continue to be afforded effective protections irrespective of the party who engages with them for their energy needs and that fair and effective competition remains. Regulatory equivalence as an important part of a fair market; effective regulation needs to follow 'supply' activity in order that consumers receive appropriate standards of service. We are therefore supportive of the review considering ways in which to better regulate parties who undertake customer facing activities, including those which are not supply but are part of the provision of services to energy consumers, such as auto-switching services, aggregators and demand side response providers etc.

Further comments on reform options are set out in our response to Question 5.

4. Would it be beneficial to allow suppliers to specialise and provide products and services to targeted groups of customers? If so, how can this be delivered while balancing the need for universal service?

Currently, we do not consider a case has been made to amend the current universal service obligation. This obligation enshrines entitlement to energy supply and a fair standard of service for all consumers. Any amendments to this universal service may have a number of unintended consequences on competition to the extent that it may lead to suppliers 'cherry picking' attractive customers leaving high cost to serve customers with those legacy suppliers who would remain subject to the universal obligation.

We believe there are already a number of options available to innovative/specialised business models who wish to target specific customer groups and that the existence of a universal obligation is not a barrier for such models to enter the market. For instance, a business wishing to target specific locational areas, rather than operating on a more national basis, could have their supply licence (and obligations therein) restricted to defined geographical areas. Alternatively, marketing and sales strategies can already be used to target particular customer groups with specific tariff/service offerings. There is also the potential for a market solution to emerge where the delivery of this obligation is met through commercial arrangements with third party service providers.

Furthermore, certain small scale suppliers can avoid the need for a licence where they fall within the existing supply licence exemptions, as set out in the Electricity (Class Exemptions from the Requirement for a Licence) Order 2001. Although this significantly reduces the regulatory burden placed on such entities, we do believe there is a need to consider the extent to which appropriate customer protection provisions apply to such unlicensed suppliers, where these are not already captured by general consumer protection law.

5. Are incremental changes to regulation sufficient to support the energy transition and protect consumers? Or does this require a more fundamental reform, such as moving to modular regulation?

As described in our response to Question 3, EDF Energy has consistently called for the introduction of direct regulation for third party intermediaries in the energy market in both the domestic and non-domestic sectors, given the risks to consumers from the growth of unregulated customer-facing third party service providers. We are therefore supportive of the review considering how best to apply, to such providers, similar customer protections to that which suppliers are subject to.

We have previously advocated for due consideration of the extent to which a general authorisation regime (as opposed to the existing supply licence model), along with greater reliance on general consumer protection law would be more effective in protecting consumers. This would allow for regulation to apply directly to the activity rather than at class entities. This approach would have many similarities to the aspirational modular approach to regulation set out in the paper that may be considered as a longer-term reform option. We accept that introducing a new regulatory framework such as this would be a fundamental change that would need careful design, take time to implement and the benefits of which would need to be established at the outset.

The existing 'supplier hub' model has delivered real benefits for energy consumers. Most notably it has provided for a single interface for consumers energy needs, a balanced energy system and security of supply, facilitated mass new entry and differentiation and been flexible enough to enable the delivery of social and environmental schemes. Furthermore, energy suppliers have been, and continue to be, given a central role in the implementation of many significant industry reform programmes (e.g. smart metering, faster switching and settlement reform). We therefore believe that any reform of regulation needs to build on the consumer benefits provided by the current model.

Consequently, we support the view that it is crucial to maintain aspects of the energy retail market that work well in the interests of consumers. A desire to take a phased approach to market reform by keeping aspects of the current arrangements in place for the medium term, including a continuation of the policy that energy suppliers are to hold a licence and consumers are to use a supplier, is the right approach. It is right to focus on those incremental changes that are needed in the current market environment, whilst at the same time ensuring that the regulatory model is flexible enough to adapt to an ever changing market environment, as we proceed with decarbonisation.

In terms of the incremental reform options presented that would have the effect of extending direct regulation to the providers of energy services, both Option 1 (New activity licences) and Option 2 (Authorisation regime alongside supply licences), have the potential to bring about greater levels of customer protection than exists today; and as such both options should be further explored. However it is important that this regulatory gap is addressed in a timely manner, in order to minimise the risks to consumers that arise from ever increasing growth in the third party services sector.

Our preliminary view is that the adoption of Ofgem issuing new activity licences (Option 1) for customer facing activities may be more appropriate in the short-medium term. This would ensure that market distortions are minimised and that consumers receive a consistent level of service and protection irrespective of how, and with whom, they engage with for their energy needs in a more diverse market. This would allow the freedom for products, services and business models to change while still enabling effective regulation (that applies to all parties carrying out such activities) to protect the consumer. This will be particularly important where non-traditional supplier models become more prevalent in the market.

We consider Option 2 to be more in line with a possible new longer-term modular approach to regulation across the energy sector, in the sense that both are a form of regulation that applies to activities rather than entities and as such avoid the need for individual licences. Consequently, as in the case of the modular option, this fundamental change would need careful design and take some time to implement. We therefore believe that to develop Option 2 for TPIs, while maintaining the existing supply licence regime for traditional suppliers in advance of the development of a sector wide modular approach to regulation, may not be the most efficient way to reform the regulatory framework at this time.

6. Are there any other potential market distortions we should be considering as part of our review?

There is a need to consider whether the regulatory framework is restricting or distorting competition. This consideration should include an assessment as to whether the imposition of the price cap itself has had positive or negative effects on the market, including the extent to which it has constrained competition or innovation. This should also include due consideration of the sustainability of businesses operating under the price cap.

The unbalanced burden, in terms of tax and policy costs, of electricity and gas is a significant barrier to energy efficiency investment and decarbonisation. In order to successfully deliver decarbonisation and a shift to electrification, this imbalance between gas and electricity must be addressed. The installation of measures that rely on fossil fuel such as gas boilers compared to electrical heat sources require significantly lower upfront investment, and have lower running costs than measures reliant on electricity due to the price of gas being substantially less than electricity. This imbalance does not encourage the electrification of heat and does not facilitate a shift to low carbon heat sources being installed at a rate comparable to what is required in order to achieve net zero by 2050. Government must consider interventions that make the electrification of heat cost-effective for the consumer. The introduction of zero or low interest loans that provide funding for electrical heat sources such as heat pumps, a future Energy Company Obligation (ECO) scheme that is focused on carbon savings, and policy that balances the cost burden between electricity and gas, would make the electrification of heat more accessible and a more attractive proposition to consumers.

While electricity is subject to a carbon price, there is no comparable carbon signal on domestic or commercial gas consumption. In addition, there are substantial policy costs associated with support for low carbon and renewable generation, which are levied on electricity but not gas. This situation represents a significant barrier to households and companies considering a switch to lower carbon and efficient electric heating in the form of heat pumps, which is counterproductive to the realisation of 2050 net zero emissions target. Government should therefore look to develop a more consistent approach to carbon pricing and policy cost allocation. We would support outcomes which gradually achieve a better balance in the burden of future costs and reflect the increasingly low carbon nature of electricity as a fuel.

There are also short term actions on energy efficiency and decarbonisation of heat that can help to stimulate a move from fossil fuel heating. The introduction of quality standards, and improvement of the Building Regulations, will increase both consumer and investor confidence in the market for energy efficiency and renewable heat technologies. We therefore support the introduction of, and would urge for greater progress on, the proposed measures under the Each Home Counts initiative. EDF Energy is also supportive of the recommendations made so far by the Competition and Markets Authority to regulate the market for heat networks, with Ofgem being best placed to do so.

In the longer term, the move away from fossil fuel heating will require a clear policy or regulatory signal. Both the government's intent to end unabated coal generation in the UK by 2025, and its commitment to end the sale of all new conventional petrol and diesel cars and vans by 2040 are examples of this approach. A similar long term signal from Government on ending the installation of fossil fuel heating will start to drive investors to cleaner alternatives. EDF Energy would agree with any approach that prevented installation of high carbon fossil fuel heating systems but with a date that sets a reasonable period of transition for both consumers and the supply chain. Given that the move away from gas central heating is a more sizeable challenge and significant cultural shift for many, a longer timescale for any such move will be needed.

As smart technologies become more prevalent in the market and less traditional supply and energy business models appear, it is essential that any market participant that plays a role in the delivery of energy is appropriately regulated and that costs across the energy system are properly captured and appropriately allocated. Regulation is required of other energy services providers, including TPIs and aggregators, to ensure quality of output and to ensure their strategy is aligned with the wider energy efficiency ambitions of the UK is essential to protect consumers. This avoids participants extracting value from the market without meeting their full share of regulatory costs.

We believe BEIS/Ofgem should also consider the extent to which the current rules on the promotion of 'green tariffs' result in customers being misled as to the environmental impact of their tariff choices. The current arrangements do little to aid the promotion of other low carbon tariffs and more generally meeting decarbonisation and net zero targets. We would like to see a wider review of the arrangements regarding tariffs that make environmental claims, including the rules around additionality in order to ensure that consumers have full transparency as to the impact they are making through their energy choices.

7. Would removing the thresholds for the Energy Company Obligation and Warm Home Discount help remove imbalances in the retail market, and could this be done without significantly increasing barriers to supplier entry or expansion in the retail market?

The removal of supplier thresholds is essential, particularly since the introduction of a default tariff cap, to prevent market distortions caused by a large proportion of smaller suppliers not having to bear a fair share of such costs. For ECO we estimate that the current value of exemptions to suppliers below the threshold exceeds the estimated fixed cost of delivery. We consider that it is important that obligations, and their cost, are equitable across all suppliers and customers. Trading of compliance obligations is available in ECO, and could be considered for other and future obligations schemes, and can be utilised to reduce any concerns of fixed operational costs which smaller suppliers may have. Smaller supplies can deliver the obligation in a fair, affordable and accessible manner, with reduced administration and costs.

8. How could the delivery burden on suppliers from the Energy Company Obligation be reduced, for example through the introduction of a buyout mechanism?

In removing obligation thresholds, EDF Energy is supportive of sensible mechanisms that allow smaller supplies to deliver the obligation in a fair, affordable and accessible manner, with reduced administration and operational costs. There are a number of ways such support could be designed, including through a buy-out mechanism or a trade-out mechanism.

Trading is currently available and can be utilised to reduce any concerns of fixed operational costs which smaller suppliers may have. Our experience is that trading is a commercial arrangement between the buyer and seller of an obligation. EDF Energy has participated in trading both as a seller (where we traded part of our CESP obligation) and as a potential buyer (where we looked to purchase some of the newly obligated suppliers' obligation in ECO2t). The price set and the cost of delivering the purchased obligation is set by a competitive market process. The resulting outcome between the price received and the cost of delivering could be either positive or negative dependant on a range of factors. As the competitive process is based on market dynamics it does not support the need of a threshold.

9. What effect does the range of Energy and Climate Change Policy Levies have on the retail market?

Please refer to our answer to Question 6 on the unbalanced burden of tax and policy costs between gas and electricity. We are also supportive of the points raised by Energy UK's in its response to this consultation question regarding the balance of cost and reform of RO and mutualisation..

Although wholesale prices have been falling, the overall cost of the bill has risen due to increases in social and environmental policy costs. We have often seen an uptake in demand for our energy services when energy prices have risen. Energy prices tend to drive the need for energy efficiency in the able to pay market. Providing consumers with greater clarity on the link between the increase in policy costs and the consumer bill (as highlighted above) can help to stimulate action.

The balance of policy costs, such as ECO should be addressed so that more is on gas with a lower proportion on electricity. This would deliver a more representative and equitable approach for consumers' paying for the obligation. There are established principles in relation to putting costs in the correct place, as we have seen in relation to the costs of decarbonising electricity. As ECO focusses on reducing heating cost it should be noted that over 80% of households in Great Britain use gas as their main heating fuel.

10. What actions could government take to reduce any negative impact of Energy and Climate Change Policy Levies?

Please refer to our answer to Question 6.

The energy market in 2018 witnessed a string of supplier failures, together with a number of defaulting suppliers which, for the first time, resulted in shortfall levels for the Renewables Obligation (RO) and Feed in Tariff (FiT) schemes being sufficient to trigger mutualisation. This results in suppliers with more robust business models and funding arrangements having to pay the bills of higher risk ventures. Already during 2019, we have again seen a number of supplier failures, such that there remains an ongoing risk of further mutualisation events. This is deeply unsatisfactory and must change.

BEIS should investigate whether proportionate and sustainable risk based credit arrangements could be established for the RO, FiT and Warm Home Discount schemes. Such arrangements, which could be modelled on existing best practice found in industry codes, would help shield other participants from the default risk of other suppliers. The need to provide cover could provide an additional incentive to ensure that suppliers take appropriate steps to remain financeable (otherwise the cost of such credit will increase) and are able to bear the risks they impose on the system.

Furthermore, both political and stakeholder perception of supplier trust (and presumptions on excessive pricing) is detrimentally impacted in instances where consumer bills rise predominantly as a result of Energy and Climate Change Policy levies. There is a real need for Government to be more transparent on the costs and benefits to consumers and the wider energy system of these or any future schemes.

11. Do you agree that now is not the time to make further changes on system and network cost recovery, metering and access to data as part of this retail market review?

Yes, we agree. EDF Energy acknowledges that for all the areas listed that there are a number of wider industry initiatives underway that will have an impact on the retail market. As such it is right that this review is joined up with these other Government and Ofgem existing work programmes and takes account of how these are evolving, the policy decisions being made and the potential for any indirect consequences on such initiatives that may result from decisions made as part of this review.

12. What total costs do suppliers face with regards to bad debt and supporting consumers who struggle to pay for their energy?

Different cohorts of customers will impose different costs on suppliers. Deemed contract customers typically represent a higher debt risk than other domestic customers, imposing higher debt collection and bad debt costs on the relevant supplier. Smaller and newer suppliers are likely to have relatively high proportions of direct debit customers (including customers paying in advance) and so have relatively low bad debt and debt recovery costs compared with the largest companies.

During the development of the Default Price Cap, Ofgem gathered data regarding the additional bad debt and administrative costs of serving standard credit customers in order to spread such costs between different payment types under the cap. We would be happy to continue to explore this issue with Ofgem and BEIS and look to gather additional (more granular) data on this matter if this would be helpful.

13. How could any potential distortions related to high cost-to-serve customers be addressed, for example by the provision of additional support services for customers struggling to afford their energy?

As set out above, we consider there to be certain customer types which impose a higher cost to serve on suppliers, and the share of these customers is higher in the customer bases of large legacy suppliers. For example, deemed contract customers typically represent a higher debt risk than other domestic customers, imposing higher debt collection and bad debt costs. The higher cost to serve is the result of reasonably incurred additional costs, and no any inefficiency in operating costs. We are therefore supportive of exploring potential measures which aim to remove any consequential distortions to competition that arise.

We are cognisant of the challenges in devising an appropriate mechanism that seeks to facilitate a more equitable distribution of the costs of managing high cost-to-serve customers, including how such customers should be identified and assessing the genuine additional costs that should be subject to such a mechanism. Whilst noting these challenges, one potential measure could be some form of levelisation mechanism, similar to that which is used under the Feed in Tariff Scheme, which could distribute additional costs amongst suppliers.

EDF Energy is fully committed to providing appropriate support to customers who are experiencing financial difficulty. This includes both short term support, to ensure customers can continue with their supply and identifying longer term support based on customer's individual circumstances. EDF Energy values the expertise that can be provided by independent third parties, particularly where a customer may not feel comfortable engaging directly with their supplier. Where appropriate, we signpost customers to our partner organisations, where they receive additional expert support and advice, including on financial management, debt relief and energy efficiency.

If additional third-party support services are to be introduced it is important that such services are funded in an equitable manner (e.g. through some form of industry levy). There is also a need to avoid any unintended consequences of such service provision, including introducing a disincentive on suppliers to directly provide an appropriate level of service to vulnerable customers or to continue to actively manage debt levels. There is a need to ensure that all suppliers have a common understanding of Ofgem's expectation is this area so that improvements in the consistency of protection for vulnerable customers across suppliers can be achieved.

14. Would addressing market distortions (for example size-based obligation thresholds for some policy schemes, supporting those who are struggling to afford their energy bills) help reduce incentives for suppliers to adopt pricing strategies that lead to excessive prices for loyal consumers? If so, to what extent (providing quantitative evidence, where possible)?

The imposition of the temporary price cap which covers a significant proportion of domestic customers provides an opportunity for BEIS/Ofgem to, in advance of its removal, review the market in order to establish whether it is operating in the bests interests of consumers. As part of this process, BEIS and Ofgem are right to consider the extent to which elements of the market are at risk of distorting competition. As we have set out in a response to the questions above, the removal of supplier thresholds is essential to prevent market distortions caused by a large proportion of smaller suppliers not having to bear a fair share of such costs. Furthermore, removal of the thresholds would result in a fairer recovery of scheme costs from customers. Currently there is a proportion of engaged customers of smaller suppliers who are avoiding such costs as a result of their choice of supplier.

We do not concur with the view that prior to the cap, the market was not competitive or that it was one where customers were experiencing excessive pricing. Price differentials are a natural feature of competitive markets and their mere existence is not in itself a signal of a poor functioning market. The Centre for Competition Policy has argued that the presence of price discrimination does not mean that there is something automatically wrong with the functioning of the competitive process[2] and the CMA has also argued that there are positive benefits to consumers of introductory pricing.

We have, as part of its effective competition assessment work under the Default Price Cap, encouraged Ofgem to provide further visibility of how price differentials will be used to reach conclusions about the level of competition in the energy market. As part of this process, there should be due consideration of the various reasons for price differentials, including differences in costs to serve diverse customer portfolios, regulatory advantages, entry and growth strategies (including unsustainable pricing), investment strategies and risk management.

15. What are your views on the measures being considered to address loyalty penalties in different markets? What approach or – combination of approaches – would be most effective in the energy retail market?

EDF Energy remains convinced that healthy and robust competition is the best way to serve customers' needs over the longer term. A well-functioning competitive market includes the ability for efficient suppliers to be able to finance their activities; and that suppliers should be able to

[2] BEIS Committee: Pre-legislative scrutiny of the draft Domestic Gas and Electricity (Tariff Cap) Bill inquiry: Consultation response from CCP", 1 December 2017

make a reasonable level of profit given the range of activities that they undertake. An effective and thriving competitive market, delivering in the best interests of consumers, requires business models to be sustainable in the long term.

Customers have a role in making markets work through choice but there will always be a proportion of customers who are unable to (as opposed to those who choose not to) engage and it is right that there are protections for such consumers within the energy market. Encouraging greater interaction by consumers, particularly those who are vulnerable, will help to mitigate the challenges presented by these disengaged customers. EDF Energy has been successful in engaging its customers, including our more vulnerable customers. However, regulatory interventions to resolve this issue should not ignore the importance of the consumer's right to individual choice. Policy mechanisms such as enforcing collective switching on certain groups of customers should therefore be avoided.

Unlike some other markets, energy suppliers are subject to sector specific rules and principle based regulations that have been implemented to ensure that consumers are treated fairly and that they receive the quality of service and products that they need and expect from an essential service. In particular, suppliers are subject to a suite of principles that facilitate engagement and enable customers to make informed choices regarding their energy needs. We are supportive of Ofgem relying more on enforceable principles rather than prescriptive rules as this will better protect consumer interests in an evolving energy market. Ofgem should ensure it is well placed to take effective action where it sees poor consumer outcomes through suppliers' failing to adhere to such principles and the wider standards of conduct.

We acknowledge that there may be a need for some form of targeted enduring protection for those customers who are unable to engage with the market due to their vulnerable circumstances, which increases their risk of being in fuel poverty. It is unclear at this stage as to what form this protection should take and the scope that should be applied. If it is determined that enduring protection is required for a subset of domestic customers then this should be made clear at an early stage so as to avoid the possible introduction of other competing remedies. It will also be important that any protection is implemented in a fair manner such that eligibility is clear, set by Government and achieved via appropriate data sharing.

We consider there to be inherent regulatory risks for suppliers in implementing a principle based regulation regime around unfair pricing. This would be a significant shift in the manner in which Ofgem currently regulate fairness, from one where the focus is on ensuring fair conduct as opposed to regulating fair pricing strategies. There would be a need for Ofgem to determine how a fair price should be determined in accordance with some criteria and be able to effectively investigate and robustly demonstrate that a party has charged prices that are in some way excessive compared to costs. Under a principles regime, it is likely that suppliers would only gain clarity as to Ofgem's methodology and interpretation in ex-post enforcement/compliance proceedings.

16. What other approaches could be adopted to ensure loyalty penalties do not re-emerge?

As we have referred to above, the imposition of the price cap provides an opportunity for BEIS and Ofgem to review the operation of the market and determine the extent to which it is operating in the best long-term interests of consumers. Given the current uncertainty as to how long the price cap will remain in place, it is important that such a review takes a holistic review of the market and also considers how best to transition from a market where a substantial proportion of domestic customers fall under a price cap, to one where competition is reengaged across the market. Timely consideration of what conditions need to be created such that a successful exit to the price cap can be achieved is required.

In undertaking a holistic market review it is important to consider the extent to which the current operation of the market, which consists of a price cap, loss making fixed prices, zero profits and several supplier failures, is a healthy sustainable market that is operating in the best interests of consumers. This review, together with Ofgem's effective competition assessment (as required under the Default Price Cap legislation), is an opportunity to assess the financeability of the sector and the potential consequences for competition and consumers.

For instance, customers are not protected by denying the ability of efficient suppliers to recover their costs. The consequences of unfinanceable suppliers are far ranging. The manner in which the price cap was developed has had the effect of driving efficiency, but has not allowed for responsible suppliers to be able to make a level of profit. In developing the cap, Ofgem appeared to assert that movement in operating costs to be on/at the efficiency frontier could offset the potential adverse impacts that might arise for a supply business that had a mix of customer types. We do not believe this to be the case for the majority of suppliers.

Furthermore, throughout Ofgem's proposals, reference was made to the possibility for suppliers to raise their fixed prices (e.g. to recover some revenues lost as a result of the cap). The reality of operating under the price cap has shown that the ability of suppliers to raise fixed prices in current market conditions is limited. In particular, it is clear that some suppliers are offering very low prices, which at times do not, in our estimation, cover the marginal costs of supply, let alone any contribution to fixed costs and EBIT. It is likely that such suppliers are pricing below cost in order to grow and achieve scale. Such prices set the market floor and prices materially above these levels do not attract, or materially retain, consumers. Therefore, the ability of suppliers to raise their fixed prices is very significantly constrained by the market floor.

There is rightly a focus on ensuring that the market works for default customers, with a key focus on reducing the real and perceived transaction costs for consumers; and looking for ways to make it easier for customers to engage and compare and switch tariffs and suppliers. However, it is also important to consider how well the more active sectors of the market are functioning. It is clearly in customers' best interests that there is an effective and thriving market that consists of sustainable businesses operating in a responsible manner.

EDF Energy observes that, while the energy supply market is experiencing high levels of new entry, there is a question mark regarding the quality of some of these new competitors, and the sustainability of their business models. A market that includes companies with unsustainable business models undermines effective and fair competition, damages consumer trust, and risks real consumer detriment. It is welcome that Ofgem has amended its approach to issuing licences and introduced a more robust approach to assessing the extent to which new entrants are fit and proper, increasing information requirements around financial resources and market understanding.

It is clear that customers suffer when suppliers fail and exit the market. We strongly believe that Ofgem should have a greater, more effective, role in monitoring the financial resilience of all suppliers on an ongoing basis. Ofgem is currently reviewing its ongoing monitoring approach and we are keen to support Ofgem in developing a proportionate approach that protects the market and customer interests. Ofgem should consider extending the requirement to produce segmental accounts to wider group of suppliers as part of new monitoring of suppliers' financial resilience.

Specifically, we note that Ofgem is considering possible rules and restrictions on the use of consumer credit balances to fund working capital. We strongly support the development of such rules given the risks we see of some suppliers financing their business using advanced payments from consumers while at the same time seeking rapid growth through unsustainably low energy prices. Such a business model will inevitably result in financial collapse once the flow of new customers slows down (or there is some cost shock). Having consumers, or other suppliers with respect to mutualised costs, bear this risk is inappropriate and unacceptable.

It is welcome that Ofgem recognise that suppliers should "bear an appropriate share of their risk" they impose on the system. Specifically, Ofgem should look to alternative measures to better protect customer credit balances without the need for mutualising these through the Supplier of Last Resort process. This could include a requirement for suppliers that cannot demonstrate to robust level creditworthiness to provide some form of surety, with flexibility provided as to the particular choice of instruments used.

17. What protections or support may be required to engage consumers in vulnerable situations in the future market?

We take our responsibilities towards all of our customers, including those who may need additional help, very seriously. This is demonstrated at the highest levels within our organisation and reflected in our Group Ethics Charter, which states we "support the most vulnerable people - amongst our colleagues or other people with disabilities or our customers in fuel poverty".

We welcome Ofgem's publication of the Draft Consumer Vulnerability Strategy 2025, including reasserting the relevant definition for vulnerability and providing the specific outcomes that are expected to be delivered. This should ensure all suppliers have a common understanding of Ofgem's expectations in this area and facilitate improvements in the consistency of protection for customers in vulnerable circumstances across different suppliers.

Ofgem's assessment is that some suppliers are not performing adequately in certain areas, including debt repayment arrangements and identification of vulnerability. Customers should be able to receive the level of service that they require from their chosen supplier, and within the current market framework they must have access to the full range of suppliers in the market, rather than only a subset who have invested in providing appropriate additional support. EDF Energy has focused heavily on building and maintaining trust with all our customers, including those in vulnerable circumstances. We do not want to see newer entrants to the market eroding trust in the wider energy retail market by performing poorly in these or other areas.

We note that Ofgem has chosen not to revise the definition of vulnerability. We agree that the multidimensional nature of the definition is useful when considering the range of factors that may cause someone not to be able to represent themselves, or to be significantly more likely to suffer detriment. It is important to have clarity on defining vulnerability when discussing specific protections, to ensure these are targeted at those most in need. For example, it would not be appropriate to provide additional financial support to those customers who may be vulnerable due to other reasons, such as those who are of Pensionable age, but who are not financially vulnerable. When proposing interventions, Ofgem should be clear as to which aspects of vulnerability or potential customer detriment these are proposed to mitigate and therefore which customers these interventions should be directed to.

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