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Last resort levy claims true-up process consultation

EDF is the UK's largest producer of low carbon electricity. EDF operates low carbon nuclear power stations and is building the first of a new generation of nuclear plants. EDF also has a large and growing portfolio of renewable generation, including onshore, offshore wind and solar generation, and energy storage. We have around six million electricity and gas customer accounts, including residential and business users. EDF aims to help Britain achieve net zero by building a smarter energy future that will support delivery of net zero carbon emissions, including through digital innovations and new customer offerings that encourage the transition to low carbon electric transport and heating.

We welcome the opportunity to comment on Ofgem's proposals for the Supplier of Last Resort (SoLR) levy claims true-up process. We have continued to engage regularly with Ofgem since the initial claims process in December 2021 and we fully support Ofgem's intent to ensure a SoLR is able to recover the additional costs incurred by supplying energy to the portfolio of SoLR customers. Further action by Ofgem to achieve this intent is essential given the high, volatile and unpredictable energy prices that have been seen over the last 12 months, and the level of the default tariff cap which does not reflect the full costs that SoLR suppliers have faced.

Executive Summary

- **EDF recommends option 4 (limiting recovery to the cost of energy that will be delivered by the end of September 2022) as we consider that the SoLR mechanism allows a fairer recovery of costs for consumers than the alternative of claiming unexpected costs through the default tariff cap, which will unfairly transfer the costs of engaged customers to unengaged customers;**
- **We agree that suppliers should look to reduce financing costs where possibe, including through using third party financing if this option reduces overall costs for consumers;**
- **We have no concerns with Ofgem's proposal to allows a SoLR to recover costs for supplying traditional PPM customers;**
- **We agree that there should be an independent audit for SoLR claims and that claims should be signed-off at board level;**

- **We consider that Ofgem should continue to allow suppliers to make multiple claims in the future as this could lower the overall costs to consumers, particularly if third party financing is involved.**

Wholesale Cost Claims

We do not support Ofgem's minded-to position that limits the recovery of additional and unrecoverable wholesale costs incurred to energy delivered up until 31 March 2022 or until the end of their 6-month SoLR direction, whichever is later (option 2). Our preference is for option 4, which would allow a SoLR to recover the wholesale costs incurred for delivering energy until the end of September 2022 through the SoLR levy.

Ofgem is claiming that option 2 would represent a fair and proportionate outcome that seeks to minimise costs to consumers, but we would disagree with this conclusion. Ofgem's conclusion is driven by its analysis on the costs for consumers, which estimates a medium scenario cost of an additional £138m for option 2 and £213m for option 4. The fundamental flaw in this analysis is that the additional costs in option 4 (£75m) represent real costs that suppliers have incurred for supplying SoLR customers, which are the unexpected costs of those customers remaining on the default tariff. Therefore, if those costs are not recovered through the SoLR process then they will form part of the costs submitted to Ofgem as part of its proposal to allowed suppliers to recover unexpected SVT costs, which will disproportionately impact disengaged customers. **Quite simply, Ofgem deciding on option 2 doesn't mean that the additional costs in option 4 no longer exist and should not be able to be recovered by appointed SoLRs from consumers.**

Given that unexpected Summer 2022 costs for SoLR customers will either need to be recovered through the SoLR levy or through an allowance within the default tariff cap, we urge Ofgem to use the SoLR mechanism as the process is more robust than the SVT adjustment mechanism and involves a clear audit from suppliers. Using the SoLR process to recover these costs also provides an opportunity for SoLRs to use third party financing, which can benefit consumers by lowering the overall financing costs and spreading costs over a long duration, easing the financial burden for customers in the short-term.

The SoLR process is also a much fairer mechanism, for both consumers and suppliers, in the recovery of unexpected wholesale costs:

Customers: using Ofgem's analysis, in the medium scenario there will be £75m of unexpected summer costs that would need to be recovered. Using the SoLR levy mechanism, this would result in an additional £2.70 per customer impact on bills in 2023/24 (using Ofgem's analysis). Using the unexpected SVT allowance, the impact for default tariff customers would therefore be >£2.70 per customer (using Ofgem's analysis) as the total cost is spread over a reduced number of customers. This is a transfer of costs to disengaged customers for the benefit of engaged customers.

We are aware that Ofgem, through its consultation on Financial Resilience, considers that a policy preventing a transfer of costs between consumer groups is positive: "*A policy that stops or reduces the extent of these transfers is still a worthwhile outcome on equity grounds: one group of* *customers generally should not have to pay for the benefit earned by another. This is particularly the case if the burden of transfers falls on disengaged and vulnerable customers."*

Suppliers: Customers that have joined a supplier as a result of a SoLR appointment are logically much more likely to be engaged in the market given they must have switched to a failed supplier in the last few years. A SoLR would have assumed a level of churn (from the SVT product) for those customers up until the end of their 6-month direction. After this point those customers would been hedged in line with BAU assumptions. Therefore, those customers that were not expected to churn would have been hedged in line with the SVT and will not have incurred additional and unexpected costs. However, a supplier will have incurred additional and unexpected costs for customers that have not churned and remain on the SVT product. The supplier would then procure the energy for those customers at a price higher than the SVT allowance. A SoLR, therefore, has an increased risk of incurring unexpected SVT costs than a supplier who wasn't appointed a SoLR at the end of 2021.

There is a risk that Ofgem will disincentivise suppliers from participating in future SoLRs if they are unable to recover their efficiently incurred costs. Appointed SoLRs provided a service to Ofgem and the wider market by stepping up at a time of great turmoil in the market and the churn assumptions were made on best available information of forward prices. The fact we are constrained by the default tariff cap means that suppliers have no opportunity to revise the pricing for relevant customers as they naturally would if assumptions change under normal circumstance. This means Ofgem HAS to intervene to enable full cost recovery as there is no other option available to appointed SoLRs.

If those unexpected SVT costs, incurred by supplying SoLR customers, are recovered through the unexpected SVT cost allowance then there will be a disproportional recovery of costs for SoLRs since the SVT allowance will be a weighted average. This will mean that suppliers that did not participate in the SoLR process will receive an allowance for costs incurred by SoLR customers, leading to an overcompensation for those suppliers. We consider that the SoLR mechanism mitigates this risk of overcompensation and allows suppliers that participated in the SoLR process to recover their reasonably incurred costs. Failure by Ofgem to allow this cost recovery is not compatible with encouraging future participation in the SoLR process by remaining suppliers

Financing Costs

We agree that any claim for the cost of financing SoLR costs should reflect a supplier's actual costs and that it should be the best possible rate that they could have achieved, including through exploring third party financing.

Traditional PPM Credit Balances

We agree with Ofgem's minded-to position that, where reasonable, a SoLR should be able to recover traditional PPM credit balances from the levy, where these are otherwise unrecoverable. Using average credit balances from a suppliers' existing smart meter PPM customers as a proxy for these balances appears sensible, although a supplier should provide accurate data if this is available rather than creating an estimation. However, Ofgem must continue to explore other options for estimating these costs given the payment behaviour of a smart meter PPM customer and a traditional PPM customer could be vastly different.

Audit Requirements

We agree that there should be an independent audit for all claims. Furthermore, the audit should be carried out by teams that have relevant expertise to scrutinise the claim and provide challenge where necessary. If an internal audit team does not have this expertise then they should provide oversight of the independent audit to ensure that it is carried out to the required standards and provide the final sign-off.

Temporary Mitigation Measures

In order to minimise costs to customers, and increase the potential for voluntary SoLR appointments, Ofgem should continue to allow a multiple claims process in future SoLRs and must enable SoLR levy claims to be submitted at any time, rather than within a single annual window. Depending on market conditions at the time, appointed SoLRs will be making a substantial financial commitment to purchase the energy for their new customers, and reducing the timeframes before the outcome of a levy claim is known will reduce the risks they are taking in doing so. Multiple claims can allow suppliers to sell their claims to a third party, if approved by Ofgem, at the earliest opportunity, which can reduce financing costs for consumers. With third party financing, any costs to be recovered as part of claim do not necessarily impact consumer bills in the short-term. Therefore, we consider that submitting multiple claims can benefit consumers.

To mitigate the risk of overpayment, Ofgem should maintain the robust claims process that it is developing as part of this temporary process, which would allow Ofgem to provide a high level of scrutiny of SoLR costs before validating any claim. Ofgem does not need to validate costs that have not yet been incurred or where it is not satisfied that a final view of the cost has been achieved. Ofgem can use its discretion to approve claims and therefore the risk of overpayment through multiplate claims should already be low.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Alex Perry or myself. I can confirm that this letter may be published on Ofgem's website.

Yours sincerely

J Cole

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