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Policy Consultation – Strengthening Retail Financial Resilience

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 continue to support Ofgem looking to introduce new measures that promote higher financial and risk management standards in the energy market, which minimise the risks and costs of supplier failures. The objective of such measures should also be the promotion of a healthy, well-functioning market that allows efficient and sustainable businesses to attain a fair margin and enable continued innovation and investment to benefit the interests of consumers.

Executive Summary

- **EDF remains supportive of Ofgem looking to improve the financial resilience of the retail market, which will lead to more sustainable competition in the long-term, to the benefit of consumers;**
- **However, the costs and timeframes to implement any new measures must be considered carefully, mindful of adding further costs to consumers, particularly in the short-term, and the risk of further destabilising the market by increasing unrecoverable costs for suppliers;**
- **We would support the implementation of the ringfencing proposals once it is clear that an efficient supplier that is providing good service to its customers can achieve a fair return for participating in this market, including in respect of the costs that will be incurred in ringfencing these funds. We do not believe that this can be achieved before next summer, at the earliest, and therefore cannot support the implementation of these proposals this winter;**
- **In the meantime, Ofgem must continue to use the extensive data it is collecting about all suppliers to identify and address concerns about any existing supplier's ability to operate in the market. It should use a risk-based approach to identify the**

suppliers most at risk and use its existing regulatory powers to intervene, where necessary, to mitigate the risk those suppliers pose to their customers and the wider market;

- **While we are supportive of Ofgem exploring options for reducing the wholesale costs to consumers of supplier insolvencies, we do not support the options currently described in this consultation.**

Regulatory Design

We, along with some other suppliers, have been calling on Ofgem for a number of years to address the risk of customer credit and renewable obligation balances needing to be mutualised following supplier failures. Such measures, had they been in place, would have greatly reduced the costs that consumers are now seeing as a result of market exits at the end of 2021.

Ofgem has already introduced new measures designed to tackle concerns around the financial resilience of energy suppliers through enhanced monitoring and information requests, stress testing, and strengthened risk controls around the financial responsibility and operational capability principles set out in the licence. Ofgem must now evaluate the extent to which the most significant risks are already being addressed before implementing proposals that will create additional costs on consumers that may be disproportionate to the level of risks that remain.

Ofgem must also be mindful of the significance of these costs for consumers while the energy cost burden for consumers is already substantial and will increase further this Winter. To minimise the cost to consumers, Ofgem should adopt a risk-based approach to identify the suppliers that it deems most at risk and use its regulatory powers to intervene to reduce the risk those suppliers pose to their customers and the wider market.

Supplier Cost Recovery

Suppliers continue to operate in a financially challenging environment and face increasing risks as a result of the continued period of market volatility and high prices, and operating under the existing default tariff cap. It is imperative that any measures introduced are targeted, proportionate and do not unnecessarily result in additional calls for capital that may further destabilise otherwise sustainable businesses and thereby directly increase the risk of further supplier exits.

Furthermore, implementing these proposals now would create additional costs for suppliers that they must be able to recover via their tariffs, whether fixed tariffs or through the default tariff cap. There must be an appropriate time period to implement these changes else currently solvent suppliers will be challenged with financing these proposals without appropriate remuneration, risking their overall ability or appetite to continue to operate in the market.

Credit Balances

Ofgem has recently concluded, through a review of supplier direct debit processes, that it has found no evidence of unjustifiably high direct debits, and it has set out its expectations on how each supplier can improve their direct debit processes. Given this conclusion, and the positive steps Ofgem has taken to monitor direct debits and credit balances, Ofgem already has the information it requires to target intervention where it is necessary and should not implement proposals that will create costs for consumers that are disproportionate to the risk of unjustifiable credit balances that could be mutualised.

Furthermore, prior to the SoLRs during the energy crisis, where the price cap prevented suppliers being able to cover the costs of the tariff they had to offer through the SoLR process, credit balances had been absorbed by the SoLR in the majority of instances and were not mutualised. As such, it is unreasonable for Ofgem to assume that credit balances will always be mutualised in the future.

The risks around mutualisation of credit balances materialise in the first place as a result of the current Ofgem safety net arrangements which demands that such balances are always protected in every instance for domestic customers. In conjunction with its extensive review of the practices of suppliers themselves, we recommend that Ofgem review the safety net to consider whether it drives a consumer response that involves due consideration of the risks in terms of their supplier choice and whether it is right that the customer bears no share of the risk if their supplier of choice ultimately fails.

Renewables Obligation (RO)

We acknowledge that the risk and potential RO mutualisation cost burden could be significantly higher than that of credit balances. We have previously called for the obligation to be reformed as a means of best addressing these risks, including removing complete dependence on the annual process which is known to be a point of financial stress for suppliers. We remain disappointed that such reforms were not developed by BEIS.

We note Ofgem's focus with these proposals is on domestic suppliers as it wants to directly reduce the costs and impacts borne by domestic suppliers of supplier failure. On this basis, any RO ringfencing calculation should be based solely on a supplier's domestic supply volumes and we urge Ofgem to confirm this as part of a further consultation of these proposals to avoid unintended distortion of competition in the non domestic supply market.

Impact Assessment

The Impact Assessment being undertaken as part of this consultation is a very positive approach. However, we have identified some significant flaws in the current assumptions and conclusions that we must raise:

1. An annual benefit of £476m is clearly overestimated. As Ofgem noted in their own consultation on credit balances during 2021, the total mutualised costs between 2018 and mid-2021 had been ~£190m for RO and ~£50m for credit balances. The higher values

since 2021 are predominantly driven by wholesale costs as a result of an energy market crisis and suppliers having to claim for costs above the default tariff cap. This is less likely to be the case going forward given the changes Ofgem is expected to make to the default tariff and it is misleading to suggest that consumers will benefit annually by an amount that is double the mutualised costs over the 3.5 year period prior to the crisis;

2. NERA have also used SAR cost estimations for Bulb in their analysis when it is currently unclear whether those costs will be mutualised onto consumer bills or not. Without these costs the benefit will be much lower than the currently high-case scenario of £476m;
3. The analysis does not consider the impact that other on-going regulatory changes will have on reducing supplier failure rates. This includes Ofgem's more robust licence application process, the strengthened reporting and milestone assessments or updating wholesale costs within the default tariff cap. Each of these should also reduce the supplier failure rate and contribute to the benefit NERA have identified, and the conclusion must be clear on what the additional benefit is of these ring-fencing proposals.

Hedging

We are supportive of Ofgem exploring options for reducing the wholesale costs to consumers of supplier insolvencies, including accessing the financial benefit of hedges held by an insolvent supplier as a means of mitigating the level of costs that could end up being recovered under a SoLR Levy Claim. As Ofgem has identified, this is a complex issue and one that is likely to require legislative change to address given the limitations of Ofgem's remit in the area of insolvencies.

As gaining Parliamentary time may be a challenge in the short-term, we are supportive of Ofgem considering what measures it could possibly introduce under its existing powers that could reduce the level of wholesale costs a SoLR would face. However, as described further in the appendix, we consider both initial options presented would be challenging to implement, likely result in additional hedging costs being incurred and would not have the desired effect. Therefore, we do not support Ofgem's current proposals.

Capital Adequacy

We are supportive of Ofgem developing a capital adequacy regulatory approach that is targeted and proportionate to the risks imposed by individual suppliers and which is designed around what Ofgem describes as lower restrictions but with enhanced ongoing monitoring of suppliers, as part of a risk-based approach. We are keen to work with Ofgem over the coming months in developing an effective capital adequacy framework that if well designed may negate the need for other specific ringfencing provision on an enduring basis.

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

Yours sincerely

J Cole

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