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Supplier Licensing Review reducing credit balance mutualisation

EDF is the UK's largest producer of low carbon electricity. We operate low carbon nuclear power stations and are building the first of a new generation of nuclear plants. We also have a large and growing portfolio of renewable generation, including onshore and offshore wind and solar generation, as well as coal and gas stations and energy storage. We have around five 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.

EDF welcomes the opportunity to feedback on the prescriptive measures Ofgem has proposed as part of the Supplier Licensing Review, specifically with the aim of reducing the risk of customer credit balances needing to be mutualised following future supplier failures. EDF continues to fully support Ofgem's Supplier Licensing Review, including the four overarching themes that have informed its licensing policy development.

Supplier Resilience

The UK government has recently set a new emissions target by 2035, which will require suppliers to be innovative with their products and services to encourage the adoption of low carbon technologies by consumers. It is vitally important that the retail market is healthy and sustainable to encourage the level of investment required for the net zero transition.

All suppliers in the market should demonstrate the financial resilience to manage their level of risk. Ofgem can monitor this through increased scrutiny of supplier financial reporting, wholesale trading strategies and growth plans. When a supplier fails and exits the energy supply market, it is disruptive for customers and undermines trust in the sector, as well as leading to additional costs for remaining suppliers and their customers. We are therefore fully supportive of Ofgem looking to introduce licensing changes that aim to improve its ongoing financial oversight of suppliers and promote higher financial and risk management standards in the energy market, which should minimise the costs and detriment that result from supplier failures for both customers and suppliers.

In the case of a Supplier of Last Resort process, these costs include the credit balances of the customers of the failing supplier. It is therefore justified that Ofgem should take steps to ensure that those costs are not unnecessarily high. The cost of implementing the proposed changes is minimal, while the proposals themselves promote good practice and encourage any supplier entering the market to be appropriately funded so that they can innovate and achieve growth.

Ofgem has highlighted c£47.6m of credit balances have been mutualised since 2018, which does not include the most recent supplier exits, nor the credit balances absorbed by a Supplier of Last Resort. The full financial value of a disorderly market exit can also include unpaid industry obligations and liabilities for various energy sourcing costs, many of which will also be mutualised across remaining suppliers and potentially passed on to customers. The ability of irresponsible suppliers to collect unjustifiably high credit balances from their customers exacerbates both the risk and the cost of disorderly exits, and requires effective regulation by Ofgem.

While customer credit balances can provide a supplier with low cost working capital, under the current safety net arrangements, this capital is risk-free and provides no incentive for a supplier to manage customer credit responsibly. In the event of a failure, a supplier does not need to prioritise repayment of customer credit as these will be absorbed by the Supplier of Last Resort or mutualised across the wider market. This has allowed irresponsible suppliers to use customer credit to finance their growth and adopt high-risk strategies, such as offering below cost tariffs, with the cost of failing being recovered across the wider market. Suppliers who create such risks should bear the associated costs, and we fully support a regulatory framework that seeks to minimise the risk and cost of disorderly market exits. We encourage Ofgem to consider whether there is a case to review the safety net arrangements and the impact they may be driving within suppliers who are at risk of failure.

Ofgem has already implemented some measures to improve suppliers' fitness to operate in the market, including additional barriers to entry and increased regulatory oversight of growing suppliers. The recently introduced financial and operational responsibility principles may, over time, have the desired impact in terms of promoting more financially responsible business models for suppliers which bear an appropriate share of their risk. However, on their own it is not certain that these new principles will lead to better outcomes for consumers in the near term. As such, we agree that further strengthening supplier requirements in a targeted and proportionate manner should ensure consumers are better protected and risks are minimised for existing suppliers and their customers in a more direct and efficient manner.

Auto-Refund Proposal

Credit balances accrued on a seasonal basis are a logical consequence of customer preferences to stabilise their energy costs with fixed regular direct debits. The issues occur when direct debits are set too high and neither supplier nor customer acts to initiate a reset.

EDF supports Ofgem's auto-refund proposal as it would help achieve Ofgem's objective of minimising the likelihood and extent that costs will be mutualised in the event of failure. The proposal is also cost-effective since most suppliers use, or have historically used, a refund process for customers similar to Ofgem's proposal, and therefore this should be a simple and low-cost change for suppliers to implement.

Additionally, we encourage Ofgem to consider the following amendments:

- EDF customer insight indicates that customers may prefer that the auto-refund minimum balance should be set to a value higher than zero, and that customers should be able to opt-out. Ofgem should commission research to gain their own customer insight on this proposal;
- The auto-refund proposal should not apply to estimated read accounts where a supplier has taken all reasonable steps to obtain a meter read but has been unable to do so due to a customer behaving in a 'manifestly unreasonable manner'.

Threshold Proposal

EDF supports the principle behind Ofgem's threshold proposal as it encourages more responsible business practice and suppliers would bear a more appropriate share of the cost of the mutualisation risk they pose to the market.

However, this proposal needs further development through collaboration between Ofgem and suppliers. Specific areas we would like to work with Ofgem to develop include:

- Relative threshold, including supplier bias for customer start dates, fuel types and payment models;
- The protections that can feasibly be adopted by suppliers and the cost of these;
- How Ofgem intends to set tolerances around the threshold to appropriately reflect the uncertain variances to consumption forecasts;
- How Ofgem intends to monitor compliance against the threshold, including providing assurance that suppliers are not inflating estimated annual bills to increase their threshold.

Other Considerations

Alongside this work to address the specific topic of customer credit balances, we hope that Ofgem will continue to strengthen its understanding and oversight of the financial resilience of all suppliers, ensuring the risk balance between suppliers and consumers is set appropriately to allow effective competition in a healthy and sustainable retail market that can deliver net zero.

Ofgem should ensure that it has visibility of the financial provisions in place for suppliers to meet their future costs, including exposure to the wholesale market through hedging strategies, as well as other policy costs (RO, ECO, SMART etc.). This will allow Ofgem to better anticipate and respond to potential instances of consumer detriment, minimising any negative impact on consumers directly, or on the market more widely.

Our further detailed answers to the consultation questions are set out in the attachment. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Jon Cole, or myself.

I confirm that this letter may be published on Ofgem's website.

Yours sincerely

A handwritten signature in black ink that reads "R. Beresford". The script is fluid and cursive.

Rebecca Beresford
Head of Customers Policy and Regulation