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Dear Giulia

Consultation: our proposed approach to dealing with supplier insolvency and its consequences for consumers

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, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

We support regulatory measures aimed at addressing problems specific to the energy market which result in consumers being placed at a disadvantage. However, we do not think that a robust case has been made to justify additional regulatory intervention aimed at protecting energy consumers with credit balances in the event of their supplier becoming insolvent.

The recent work carried out by the Law Commission has concluded that it is neither possible nor desirable to protect consumers who have paid in advance under all circumstances, and that protections should be structured to prevent inappropriate incentives on failing companies which increase consumer harm in the period immediately prior to an insolvency. We support the Commission's recommendation to amend the hierarchy of debtors to give consumers greater rights and would welcome this being implemented in due course.

The commission's recommendation is targeted at protecting consumers who have paid in advance by cash or cheque. Because these consumers tend to be drawn from less well-off socio economic groups, we believe that the Commission's work addresses one of the key objectives of this consultation; that protections should be focussed on vulnerable and fuel poor consumers.

We do not believe there is a case for Ofgem to take further steps to protect energy consumers. To do so could risk a moral hazard where there is a lack of incentive for consumers to guard against the risk of a company defaulting as they are protected from the consequences. This would result in one group of customers benefiting from this moral hazard and potentially cheaper energy prices, with other consumers who have not benefited from these prices having to bear the consequences.

However, if despite the above, Ofgem does decide to use the Supplier of Last Resort (SoLR) process to provide further protections in this area it is essential that there is clarity as to their preferred approach and methodology. For example, whether they would expect prospective SoLR companies to bear such costs in their SoLR deemed tariff or for this to be borne across all energy customers.

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[Redacted text]

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

Yours sincerely,

A handwritten signature in blue ink that reads "Paul Delamare".

Paul Delamare
Head of Customers Policy and Regulation

Attachment

Consultation: our proposed approach to dealing with supplier insolvency and its consequences for consumers

EDF Energy's response to your questions

Q1. Do you agree with the approach to SoLR and energy administration set out in our revised guidance?

Comments on the SoLR process

The key objective of the Supplier of Last Resort (SoLR) process is to ensure continuity of supply for the customers of failed suppliers. We agree that the process outlined in the guidance reflects the flexibility needed to ensure continuity of supply across a number of scenarios involving suppliers with a wide range of operating models.

However, whilst we agree that the SoLR process currently provides Ofgem with the power to protect consumers' credit balances, we do not believe that the use of these powers is justified. Our view is that it is unfair to spread the costs of a failed supplier across all consumers in the market and that this creates a moral hazard. This is because there is a lack of incentive for consumers to guard against the risk of a company defaulting as they are protected from the consequences. This would result in one group of customers benefiting from this moral hazard and potentially cheaper energy prices, with other consumers who have not benefited from these prices having to bear the consequences.

A supplier may be able to put low prices into the market by choosing not to manage risks which could result in insolvency, e.g. by not hedging their customers' demand when wholesale prices are falling. The customers of such a supplier will benefit from the low prices, so it is appropriate that they should also bear the risks associated with such an operating model.

It seems difficult to justify why consumers who have chosen a supplier with a lower-risk operating model should pick-up the costs when a high-risk supplier becomes insolvent. A more appropriate approach for Ofgem to take would be to ensure that all suppliers operate responsibly so that consumers' exposure to losses is limited.

Comments on the revised guidance

We support incorporating the changes brought in under the Energy Act 2011 to allow an Energy Company Supply Administration Order (ECSAO). This makes it clear that there is an alternative to the SoLR process which may be used in certain circumstances.

As this guidance is intended to provide an overview of the SoLR process, our view is that it is sufficient to make reference to the ECSAO process and that this would only be used where an SoLR approach is not feasible, outlining the circumstances under which the SoLR process will be used and when the ECSAO process will be used. Our view is that whilst the guidance establishes a high-level hierarchy of actions which can be taken in the event of a supplier failure, it does not provide clarity as to the circumstances under which each

of these actions will be taken. We suggest that Ofgem re-drafts Chapters 1 and 2 of the guidance to make this clearer.

Q2. Do you agree with our preferred approach (option 1 - no further action, i.e. case by case use of SoLR powers) to protect consumer credit balances?

We would be particularly interested in hearing your views on the following factors in relation to each option: effects on innovation and potential barriers to entry, increased regulatory burdens, impact on customer behaviour, proportionality.

Option 1 – no further action, i.e. case by case use of SoLR powers

We agree that Option 1 is the most appropriate option at this time as we do not think that the case has been made for additional regulatory intervention.

The Law Commission's detailed work in this area has resulted in recommendations which, if implemented, will provide additional protection to all consumers and which are targeted and proportional. Our view is that these measures will be sufficient to protect consumers in the energy industry.

We do not support the ex-post socialisation of a failed supplier's costs via the supplier levy. Such an action would result in the benefits accrued by the customers of the failed supplier being subsidised by all other energy consumers.

However, if despite the above Ofgem do decide to use the Supplier of Last Resort (SoLR) process to provide further protections in this area it is essential that there is clarity as to their preferred approach and methodology. For example, whether they would expect prospective SoLR companies to bear such costs in their SoLR deemed tariff or for this to be borne across all energy customers.

Option 2- Ring-fencing or trust arrangements for consumer balances

We do not support the ring-fencing of credit balances as this option would be complicated and costly to implement, and there could be negative impacts on suppliers' financial positions which are not proportional to the risks borne by consumers.

Ring fencing of credit balances would reduce suppliers' available working capital and could have an impact on their credit ratings. Any impact on working capital and credit rating is likely to have a disproportionate impact on smaller independent suppliers. Changes to supplier systems would be required to identify which customer payments are received when a customer's account is in credit, and to allocate those payments to a separate supplier account. It is likely that every transaction would need to be monitored and some payments would need to be split between two supplier accounts.

System changes would also be required to identify when a credit balance is due to pre-payment of energy charges, rather than due to, for example, a Warm Home Discount (WHD) payment. All of this would need to be reported by suppliers and monitored by

Ofgem, which would increase the regulatory burden disproportionately to the benefit that consumers receive.

Option 3

Industry-wide insurance scheme

We do not support the use of a mandated industry-wide insurance scheme. Such a scheme would provide protection for consumers, but it would not provide any incentive for suppliers to operate responsibly and could therefore manifest as customers of responsible energy suppliers paying to protect the customers of suppliers with less robust operating models.

With low barriers of entry into the energy markets and some suppliers relying heavily on their customers' credit balances to fund their business activities, this proposal seems to be an inefficient approach to protecting consumers and is likely to result in increased retail prices across the market.

Mandatory bonding arrangements

We do not support the use of industry-wide mandatory bonding arrangements.

Bonding arrangements would allow each supplier's level of exposure and risk to be reflected in the cost they bear to protect their customers' credit balances, making it a more accurate reflection of 'the cost of doing business' than an insurance scheme.

However, the fact that bonding arrangements would impose a higher cost on riskier suppliers is likely to create barriers to entry as most new market entrants will be regarded as highly risky until their business is established.

Q3. Do you consider that there is other information which would help you decide whether to volunteer to be a SoLR and on specific terms? If so, what is this information and from whom should it be sought?

It is critical that suppliers are provided with sufficient information on a failed supplier's portfolio to be able to make an informed decision as to whether they are the right supplier to act as SoLR. This includes:

- The total number of customers in the supplier's portfolio, split by domestic and non-domestic if the failed supplier serves both.
- The number of single fuel and dual fuel customers in the supplier's portfolio.
- The number of customer accounts split by:
 - Tariff (including duration and prices)
 - Discounts
 - The average annual consumption details for each of the splits listed above.
- The % of total revenue unbilled.

- The total value of consumer credit balances and Ofgem's preferred approach to such sums.
- The total value of consumer debt balances and Ofgem's preferred approach to such sums.
- The number of Smart meters in the supplier's portfolio.
- Details of any environmental commodities which would be transferred to the SoLR, e.g. ROCs.

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