Ofgem
9 Millbank
London
SW1P 3GE

31 January 2018

Providing financial protection to more vulnerable 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, storage, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

EDF Energy continues to believe that healthy and robust competition is the best way to serve customers' needs over the long term. We therefore welcome Ofgem's continuing work to promote customer engagement and make it easier to switch tariffs and suppliers.

EDF Energy acknowledges that Ofgem is keen to further extend protection to more vulnerable customers – suggesting that an additional two million customers could be protected by broadening the scope of the safeguard tariff. We support protection for vulnerable customers. However, to ensure this consumer protection is implemented fairly it is essential that eligibility is clear, set by government and achieved via data sharing. This would ensure that all eligible consumers are protected whoever supplies their gas or electricity, with any cap set at a level which allows suppliers to recover efficient costs.

In terms of the previous extension of the prepayment (PPM) cap for vulnerable customers that is to be introduced in February 2018, EDF Energy accepted the use of the CMA's PPM cap methodology to set the level of the extended safeguard tariff and the receipt of Warm Home Discount to determine eligibility, on the basis that this will only be for a limited time and for a limited number of customers. We recognised that Ofgem was keen for the extended protection to be introduced as soon as possible.

However, each widening of the scope of any cap to more customers increases the impact, and therefore the risks to consumers and suppliers if the level is not set appropriately. Such significant regulatory interventions should be supported by robust and comprehensive analysis wherever possible. We would naturally be very concerned if each time the cap is to be extended insufficient time may be given as a reason why it is not possible to undertake a robust review of the methodology and ensure that the cap is set at the right level.

In setting a target date for extending the vulnerable price cap of next winter, we recognise the challenges Ofgem faces and we are keen to explore with Ofgem how these could be addressed. In the short-term, we believe Ofgem should, in terms of setting the initial cap, focus its resource on making amendments to key elements of the current methodology which we believe are most material to improve the accuracy of the cap calculation and are achievable within the constrained timeframes. Consequently, we believe there should be a focus on the following areas:

- **Smart metering**: the smart programme is a significant and growing cost to consumers, and it is not adequately reflected in the current PPM methodology. If

EDF Energy
90 Whitfield Street
London W1T 4EZ
Tel +44 (0) 20 3219 6937

edfenergy.com

*EDF Energy plc.
Registered in England and Wales.
Registered No. 2366852.
Registered office: 90 Whitfield Street, London W1T 4EZ*

suppliers are to continue to invest in their roll-out plans, it is essential that they can recover their costs. The costs faced under the current programme will be very different to those incurred by the benchmark companies in very different circumstances (e.g. with already smart-engaged customers). Ofgem should carry out a full analysis of the costs identifying what was included in the CMA's initial benchmark and collect smart metering costs from suppliers and ensure the real costs of the programme are fully accounted for in the cap level.

- **Economy 7 split:** the split of costs in the Economy 7 (E7) benchmark assumed policy costs are the same for an E7 customer as they are for a standard electricity meter customer. As policy costs are largely variable based on consumption, and E7 customers are high electricity consumers, the policy costs for an E7 customer should be much higher. Over time, this inaccuracy results in a divergence between actual and allowed costs. Policy costs have increased at a higher rate than wholesale energy costs since 2015, and this higher rate of increase has not been applied to a sufficiently large proportion of the benchmark cost.
- **Updates to policy cost base:** the price cap methodology should be revised to allow updates to the base period data, where these become available e.g. FIT costs were reduced by the OBR for 2015-16, but not revised downwards in the PPM mechanism, meaning insufficient increases have been applied later to reflect the current cost level.
- **Bad debt costs:** The CMA capped bad debt costs in the PPM cap at one percent of revenue. Large suppliers can face higher levels resulting, for example, from substantial populations of deemed customers.
- **Pension deficit costs:** allow companies to recover deficit costs associated with the historic pension obligations (not incurred by the benchmark companies)
- **Headroom**, the CMA set a low headroom for the PPM cap (£15 per fuel). Ofgem should set an appropriate headroom that enables competition, ensures suppliers can continue to cover their costs, and incentivises customers to engage in the market. Ofgem should conduct research on the relationship between price and consumers' action to engage.

We note from the State of the Market report, released late last year, that Ofgem are seeing evidence of higher profits in gas (11.1%) than in electricity (-1.1%). There have been a number of drivers for that could have led to this and we have met with those involved in preparing this report to share our views. A key issue has been the growth in policy costs on electricity bills (FiT, RO, CFD) yet internal constraints on suppliers to increase the level of tariff prices, which has created this divergence in fuel margins. Therefore, both because of the tighter margins available for electricity and far larger share of policy costs that fall on electricity any errors in reflecting policy costs will disproportionality impact on electricity supply. Therefore, it is key that Ofgem consider the impact on each fuel separately to ensure they can fully understand the impact of the decisions that are made. We would anticipate that there should not be any great divergence in the allowable margin on gas and electricity supply under a price cap and this is something that should be a key focus for Ofgem in developing an appropriate methodology.

We provide an confidential Annex which further details how the above and other amendments could be made to the methodology, easily and in good time, to meet Ofgem's current timetable.

In terms of the proposals presented in the consultation paper, EDF Energy does not support a basket of market tariffs being used. It is our view that this would result in volatile price changes for customers and potentially be open to manipulation by individual suppliers in the market, a conclusion the CMA also reached in their investigation. Therefore, we would strongly recommend that this is not further explored.

The important principle is that all vulnerable customers receive protection, regardless of who their supplier is. This should be achieved by robust data matching for all suppliers. This will ensure that all energy suppliers can take a fair and equitable role in supporting vulnerable consumers. We outline in the attachment that a simple way of achieving this could be to extend the number of suppliers who participate in the WHD, and can therefore benefit from full data sharing.

As the core objective of this cap is to ensure that the amount that low income consumers are paying for energy is capped at an appropriate level, it is appropriate that they are protected irrespective of meter type. However, we would recommend that consumers do not become eligible until they have been on a default tariff for at least six, and ideally twelve, months. This would simplify implementation greatly and ensure that engagement nudges at the end of a fixed term deal were not complicated or overwhelmed by messaging around the safeguard tariff. Delaying the move to the Safeguard Tariff for a short period also retains the incentive to engage for those customers who have already demonstrated that they can engage in the market while also offering protection if customers fail to do so.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact John Mason on 07875 117690, or myself. I confirm that this letter and its attachment may be published on Ofgem's website. However, the accompanying annex to this response should be treated as confidential.

Yours sincerely,

Paul Delamare
Head of Customers Policy and Regulation

Attachment

Providing financial protection to more vulnerable consumers

EDF Energy's response to your questions

Chapter 2 – Scope

Q1. What are your views on our preferred approach of identifying consumers for safeguard tariff protection by primarily relying on data-matching?

EDF Energy fully supports data-matching being used to identify consumers for Safeguard Tariff protection. Any other approach has significant drawbacks and therefore this is the approach that should be implemented.

We fully support the full utilisation of the powers under the Digital Economy Act 2017 which is currently being implemented. We believe the Act's powers facilitate the required sharing of data and disclosure of information to gas and electricity suppliers. Our understanding is that there are two requirements that once met, allow a specified person (government department) to disclose information to a licensed gas or electricity supplier. The first condition is that the disclosure is for the purpose of assisting people living in fuel poverty by …(a) reducing their energy costs. This clearly falls within the remit of the safeguard tariff protection. The second is that it is for the purposes of supporting specified support programmes, such as the Energy Company Obligation (ECO) and Warm Homes Discount (WHD), which could be linked to the eligibility for the Safeguard Tariff.

For example, to provide clarity that these powers can be used to support the identification of consumers who could benefit from the Safeguard Tariff, we would note that both the ECO and WHD will have legislative measures passed through Parliament in 2018. This would provide an appropriate opportunity if any further legislative approval is required. Due to this, EDF Energy is hopeful that Ofgem and the government can work together to ensure that full data sharing is implemented for the extended safeguard tariff protection. One approach could be to extend the number of suppliers who participate in the WHD and can therefore benefit from full data sharing.

Q2. What are your views on our backstop option that requires suppliers to use the information they hold (such as Priority Services Register and debt information) to identify vulnerable consumers?

Any backstop option should only be used as a last resort as data sharing is by far the best approach. For all WHD obligated suppliers, we cannot foresee any reason that another solution would be required.

A key concern for any of the approaches considered in the consultation document is where this involves either suppliers identifying customers or customers identifying themselves. Such an approach often leads to the most vulnerable not being engaged. This has been a key concern for EDF Energy in using those in receipt of Broader Group WHD rebates. The most vulnerable are least likely to apply for such support.

However, we recognise that to ensure all suppliers are participants there may be instances where some suppliers require an alternative approach to data sharing to identify customers who would benefit from Safeguard Tariff protection. In such instances, a bespoke approach may need to be developed with debt a potential indicator.

The Priority Services Register (PSR) is not appropriate as this identifies non-financial vulnerability and so is not aligned to the key objectives of the Safeguard Tariff. The PSR is designed to ensure that suppliers provide additional services for those who require them due to reasons such as disability, for example, by taking additional meter reads for those customers who are unable to take meter readings by themselves. However, this was not designed to identify financial vulnerability and is therefore not appropriate to be used as a basis for providing financial protection via a price cap.

A key concern is that any such 'proxy' indicator which is reliant on wider supplier practices could result in perverse outcomes. For example, Ofgem recently published a report which identified that many smaller suppliers were not appropriately taking 'ability to pay' principles into account in how they recovered debt and were not as successful as identifying those who should be registered on the PSR. Therefore, if these proxies are used in a non-sophisticated manner, it could mean that suppliers who are less focussed on protecting vulnerable consumers have a perverse incentive not to identify customers who should be registered on the PSR and therefore benefit from safeguard tariff protection.

Q3. Are there other methods for identifying vulnerable consumers that we should consider, either alongside or as an alternative to, our preferred approach?

For the reasons outlined in our response to Question 2, careful consideration needs to be made in how any non-data sharing proxies which may be required are implemented, focussing on ensuring that any approach is fair across suppliers and transparent for consumers. One potential control would be to ensure that any suppliers not using data sharing are complying and identifying customers based on a clear definition set by Ofgem. Where suppliers not using data sharing are only identifying a low number of customers then Ofgem should proactively investigate to ensure that they are taking reasonable steps to do so.

Q4. What are your views on our proposal for all suppliers to be required to provide safeguard tariff protections to vulnerable consumers? What impact would this have on suppliers? Please provide evidence to support your views.

EDF Energy fully supports all retail suppliers being obligated to provide Safeguard Tariff protections to vulnerable customers. We have supported the Safeguard Tariff since inception but on the basis that it should be applied to all suppliers, so that all vulnerable customers defined by the scheme are protected. Therefore, before the cap is extended further is it is essential that all suppliers are obligated.

We do not believe the technical requirements required to achieve this are demanding and cannot be built into the Software as a Service offerings used by smaller suppliers. Within the timeframes, all suppliers will have to adhere to the General Data Protection Regulation

(GDPR) suggesting that they can control the use of sensitive personal data. There is not any credible reason why a smaller supplier cannot participate and have the competence to do so, as this is the same basic skill sets that are required to responsibly provide customer service and consumer protections. Therefore, no one should be exempted unless they can provide compelling evidence as to why they cannot participate.

We recognise that Ofgem is concerned that participating in government data sharing could be challenging for some suppliers. However, the fact that some smaller suppliers with an ethical outlook have been able to volunteer to participate in the WHD scheme demonstrates that this is possible.

Q5. What are your views on our proposal regarding the tariff types and meter types our extended safeguard tariff protections would apply to?

EDF Energy understands that as the Safeguard Tariff protections relate to financial vulnerability then, unlike the CMA prepayment cap, this should apply to all meter types.

We also recognise that as this is a measure to protect those who are financially vulnerable and ensure that their energy costs are capped, there is not a strong argument for waiting until their disengagement is proven e.g. three years on a default tariff. However, it is widely accepted that consumers are best served by engaging in the market and choosing the tariff that best meets their needs, it is therefore important that incentives to engage remain strong. Consequently, for simplicity and to encourage such engagement, we would recommend that consumers do not become eligible until they have been on a 'default tariff' for at least six, and ideally twelve, months. This would simplify implementation greatly and ensure that engagement prompts at the end of fixed term periods are not complicated or overwhelmed by messaging around the Safeguard Tariff. This would also ensure that customers who are already on a fixed deal retain an incentive to choose a new fixed deal. These customers have already shown that they are able to do so and it is in their best interests to, but they are protected if they do not after a period.

Chapter 3 – Methodology

Q6. Which of our two options for setting the benchmark component of the safeguard tariff would be most effective?

EDF Energy does not support a basket of market tariffs being used. It is our view that this would be unpredictable, leading to price volatility and potentially open to manipulation by individual suppliers in the market irrespective of how the methodology is developed. We agree with the problems Ofgem has identified regarding whether fixed prices reflect sustainable cost levels, and the resulting need to consider an increased headroom.

Therefore, we would strongly recommend that this is not further explored. We have explored several scenarios for how this could be implemented and have serious concerns with each.

Of the two options, we are supportive of Ofgem focussing on updating and improving the CMA's prepayment cap methodology with practical and simple improvements. This should include the improvements we have outlined in our Annex, including in particular taking account of the costs of the smart meter programme.

Q7. Do you have any comments on the design issues for either of our two options?

We have outlined our suggested approach in Annex 1 for updating the CMA PPM cap methodology to ensure this remains fit for purpose. As we have outlined in the Annex, this could be updated simply and quickly by Ofgem to ensure that the methodology accurately reflects suppliers' costs. If this is not implemented, there is a real risk that costs will be inappropriate which would mean that suppliers cannot fairly recover their justifiable costs which would lead to unexpected consequences in the market.

EDF Energy
January 2018