To chief executive officers of energy supply companies, gas shippers, Distribution Network Operators (DNOs), Gas Distribution Networks (GDNs), Transmission Owners (TOs), and the Electricity System Operator (ESO)

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Dear colleague

Managing the impact of COVID-19 on the energy market – introducing the option of relaxing network charge payment terms for suppliers and shippers

First, I want to echo the thanks of the Secretary of State for Business, Energy and Industrial Strategy in his letter to the energy industry dated 30 April.[1] We all depend on a safe and reliable supply of electricity and gas. You and your colleagues are continuing to play a vital role in delivering an essential service to energy consumers at this challenging time.

This letter outlines what support we expect to be available for energy suppliers and shippers who are facing cash flow challenges as a result of the unprecedented public health emergency triggered by COVID-19. Our overarching aims are to ensure that energy consumers are offered the support and service they need, to minimise disruption for consumers and other market participants that could arise should companies exit the energy market in a disorderly way over the next few months, and to mitigate the risk to consumers of a material decline in competition arising from the potential exit of otherwise efficient suppliers. I would like to thank the network companies for driving the development of schemes[2] which are aimed at helping to mitigate the impacts of COVID-19 on energy consumers, through enabling the temporary relaxation of payment terms for suppliers and shippers.

1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/882426/beis-sos-letter-to-the-energy-sector.pdf

2 To give effect to these schemes, industry may choose to bring forward code modifications, if appropriate. This open letter is without prejudice to any decision that Ofgem may be asked to make to give effect to such schemes, if appropriate, such as in response to industry code modification proposals.

These are difficult times for energy consumers, with many households and businesses facing financial challenges. This in turn has impacts on the energy supply chain, for example, because of bill payment defaults by both domestic and non-domestic customers, and the losses for suppliers arising from significant reductions in energy use by businesses. In response, suppliers have agreed with government to provide relief to customers experiencing hardship as a result of COVID-19,[3] and we have asked suppliers to consider what support they can extend to their non-domestic customers.[4]

As a consequence of the impacts on the energy supply chain, suppliers (and in turn shippers[5]) may find themselves experiencing cash flow issues, which could have negative impacts on consumers. We would expect suppliers and shippers with cash flow issues to seek to access commercial loans or the government's and Bank of England's financial support facilities.[6] However, we are aware that the eligibility criteria and loan value caps on the schemes may prevent some suppliers and shippers from being able to meet all their liquidity needs through them alone.

Schemes to address risks to consumers arising from cash flow issues

We therefore asked the energy network companies, through the Energy Networks Association (ENA), to develop schemes to provide relief to cash flow-constrained suppliers and shippers in a way that is financially viable for network companies, which we have reviewed.

To best target the support available, the schemes they have developed in response cannot be used by suppliers and shippers who have an investment grade credit rating and can therefore be reasonably expected to be able to access alternative sources of liquidity outside these schemes. The deferral of network charges by such companies would exhaust network companies' capacity to support these schemes, meaning that less support would be available to suppliers and shippers for whom alternative support is not available.

For eligible electricity suppliers and gas shippers, the schemes being developed would offer an "extended period" which we expect would allow the majority of monthly network

[3] https://www.gov.uk/government/news/government-agrees-measures-with-energy-industry-to-support-vulnerable-people-through-covid-19

[4] https://www.ofgem.gov.uk/publications-and-updates/impact-covid-19-retail-energy-supply-companies-enabling-framework-regulatory-flexibility

[5] In respect of gas, it is shippers, rather than suppliers, who are responsible for activities such as paying network companies and booking capacity. Often, the shipper is part of the same company or group as the supplier, but some suppliers buy in shipper services. Supplier cash flow issues could therefore affect shipper cash flow.

[6] Facilities include the COVID Corporate Financing Facility (CCFF), Coronavirus Business Interruption Loan Scheme (CBILS) and the Coronavirus Large Business Interruption Loan Scheme (CLBILS). https://www.gov.uk/government/collections/financial-support-for-businesses-during-coronavirus-covid-19

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charges to be paid at a later date. There would be no requirement to provide additional security to cover the amounts outstanding for the "extended period", nor an obligation on the network companies to seek and have this in place. Common features have been agreed by all the network companies across the gas and electricity sectors. However, the implementation details would vary in each sector and will be set out in due course. Broadly, the schemes would:

- Only be available to companies where neither they themselves, nor any member of their corporate group have an investment grade credit rating and therefore have fewer options for securing financing.
- Allow eligible electricity suppliers and gas shippers to request a temporary suspension of non-payment escalation processes.
- Relate to electricity distribution network charges for electricity suppliers, and to gas distribution transportation capacity charges and gas transmission transportation charges for gas shippers. National Grid Electricity Transmission and National Grid Electricity System Operator have been involved in the development and are supportive of this initiative, and will join the scheme, subject to the outcome of other requests for COVID-19-related support. SHE Transmission are also supportive in principle of joining the scheme, subject to further review.
- Apply to payments due over a three-month period. The specific time periods to which the arrangements would apply may vary somewhat across the different sectors and will be made clear by the companies in the coming days.
- Be sized and available so as not to threaten a network's ability to comply with its financial covenants and credit metrics.
    - Require a minimum payment of 25% of the monthly invoice amount.
    - Be capped at £1.6m per electricity supplier group and at £1m per gas shipper (both per network licence area and over the scheme length of three months), offering around £350m in total for eligible electricity suppliers and gas shippers.
    - Be capped per network company group.
- Ensure that any deferred payments would accrue interest at the default rates set out in the relevant industry codes (currently c. 8%), to incentivise suppliers and shippers to only defer as much as is necessary and return to normal payment terms as quickly as possible.
- Require that any deferred payments be repaid by the end of March 2021 with instalments payable prior to that deadline.
- Require electricity suppliers and gas shippers to self-certify that their companies will not pay dividends or executive bonuses until deferred charges plus interest are repaid.

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- Be withdrawn by a given network company if at any time any entity in that network company's group would breach any of its financial covenants by continuing to provide the scheme.

Having reviewed these proposals, we would now encourage industry to consider the appropriate approach to give effect to these schemes. Should it be necessary to propose a change to any industry codes, for example, to give effect to any scheme, we would consider any proposed changes together with any further views and evidence from industry parties that may be submitted as part of any code modification process.

We would expect suppliers and shippers to only access such schemes as a last resort.[7] Ofgem would monitor uptake carefully to mitigate the risk of abuse. For example:

- We would expect suppliers and shippers availing themselves of these schemes not to pay out dividends, and show restraint in relation to senior management pay (such as cash bonuses or pay rises) until all charges and interest that fall due under the proposed schemes have been repaid.[8]
- As part of our Supplier Licensing Review,[9] we explained that we expect suppliers to have appropriate capability, processes and systems in place as a pre-requisite to being able to meet their obligations. This would include managing their risks and meeting their financial obligations. While our policy work in this area is still in progress,[10] we expect suppliers to take into account the aims of the Supplier Licensing Review in relation to their use of these schemes.
- We would expect suppliers to continue to act in line with their various legal duties and regulatory requirements. This includes the requirement to take into account creditors' interests when a supplier is insolvent, or where there is a real possibility of insolvency, and to treat customers fairly.

We would expect network companies to take appropriate action to enforce any scheme, if any supplier or shipper failed to repay deferred charges in line with any proposed scheme. We would also consider what action it may be appropriate for Ofgem to take in circumstances where a supplier has not met the above expectations and has failed to repay deferred charges in line with any scheme. For example, if a supplier that had failed to repay

[7] Given any network relief schemes would relate to gas shippers and not gas suppliers, we would consider it up to the gas shipper to decide to what extent they pass on relief to the suppliers they ship for.
[8] Similar conditions are in place for the government's CLBILS scheme and the Bank of England's Covid Corporate Financing Facility.
[9] https://www.ofgem.gov.uk/publications-and-updates/supplier-licensing-review-ongoing-requirements-and-exit-arrangements
[10] We have temporarily paused the publication of our statutory consultation on some of our Supplier Licensing Review remedies to ensure suppliers and wider industry have the ability to participate fully in the consultation process. We expect to proceed with this consultation at the earliest opportunity.

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deferred charges exited the market, and the directors or those with significant influence within the supplier subsequently sought to re-enter the market, this action would be an important consideration in any decision for us to grant a licence to them. In addition, subject to the outcome of our Supplier Licensing Review consultation, we may introduce new rules requiring suppliers to ensure they are financially resilient and have protections in place to minimise the need for costs to be mutualised across other industry parties should they fail. In assessing supplier compliance with any such rules when they come into effect, we would expect to take into account any financial actions taken by suppliers, such as paying dividends, in conjunction with their progress repaying any deferred network charges by the relevant deadline.

Should any supplier or shipper that takes advantage of such schemes subsequently leave the market, we would expect network companies to pursue any debt through the liquidation process. However, where network companies have sought to do this, they will be able to recover outstanding bad debt within the year 2021/22. To ensure that consumers benefit from any interest accrued by networks due to the proposed schemes, we propose to treat any interest accrued, net of the cost of capital, by network companies as revenue under the price control. In due course we will propose any licence modifications required to give effect to these.

We recognise that the flexibility of the network companies to support suppliers and shippers is limited, and Ofgem will take this into account when considering any further proposals which would have an impact on the network companies' revenues or cash flows.

Impacts on the price cap

We have received enquiries from suppliers on whether we will adjust the default tariff cap to reflect additional costs such as the cost of bad debt that suppliers may incur due to the impacts of COVID-19. The default tariff cap protects customers from being overcharged and ensures they pay a fair price for energy. Customers can be confident the price reflects the true costs of supplying energy.

The default tariff cap allows suppliers headroom to take account of unexpected costs, like a short-term increase in bad debt. We do not have sufficient evidence to justify amending the price cap to reflect increased bad debts for the next six-month cap period starting in October 2020. In the longer term, if there is a material change in suppliers' costs as a result of COVID-19 impacts, including bad debt costs, we will consider how to reflect these in the default tariff cap methodology while protecting existing and future domestic default tariff customers.

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I hope this letter makes it clear to suppliers and shippers how we would expect the schemes described above to be used. We thank the ENA and energy network companies for playing their part to ultimately help energy consumers cope with the impacts of COVID-19.

Jonathan Brearley
Chief Executive

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