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Statutory Consultation on modification to the Electricity Distribution Licence to recover the costs associated with appointing a Supplier of Last Resort

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 around five million electricity and gas customer accounts in the UK, including residential and business users.

Following our recent response to Ofgem's informal consultation on this proposed change, EDF Energy remains opposed to elements of the proposals put forward in this statutory consultation, pending a robust supporting impact assessment (in particular the provisions described in 38B.5 and 38B.6). We are particularly concerned that these changes serve to enable faster recovery of mutualised Supplier of Last Resort (SOLR) costs by Distribution Network Operators (DNO) from suppliers, where suppliers are not able to recover these sums via existing fixed term tariffs. This undermines Ofgem's policy that SOLR costs should be borne by consumers.

We note in the statutory consultation document that Ofgem has agreed with previous respondents that the proposed measures are '*...short term until a more enduring solution can be found*'. Given the next Relevant Regulatory Year will commence from 1 April 2020, and several potential SOLR claims (from events in 2018 and January 2019) remain outstanding at this time, the regulator has a window of opportunity to give these proposals, and the alternative options Ofgem is currently reviewing, more thorough examination prior to implementation.

To reiterate EDF Energy's recommendation from our response to the informal consultation in 2018, Ofgem should conduct an impact assessment to gauge the impact these temporary changes will have on consumers and relevant industry parties. This would be essential for any enduring solution. Such an exercise would represent good practice in line with the Better Regulation Framework: Guidance 2018¹, whereby Qualifying Regulatory Provisions, carrying a potential Equivalent Annual Net Direct Cost to Business²

¹https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/735587/better-regulation-framework-guidance-2018.pdf

² See Better Regulation Framework: guidance, para 1.2.6.

of greater than £5m, should be subject to cost-benefit analysis by the Relevant Regulator. Additionally (given the temporary nature of this change), a pre-implementation impact assessment would provide a benchmark for subsequent evaluation of the success of the changes.

The cost impact on suppliers, beyond the Materiality Threshold, has not been robustly measured at this point. Under the existing Condition 38 provisions there have been two incidences of SOLR claim costs put into network charges (Cooperative Energy's claim in 2018, and Octopus Energy's claim in 2019). We note the increase in network charges related to the latter claim (totalling £7.2m, for electricity) has been incorporated in the tariff cap benchmark from 1 April 2019. However, these network cost increases will also affect the cost of supply to domestic customers on fixed tariffs. Suppliers are therefore constrained from recovering a significant proportion of the increased network costs by the prohibition of changes to fixed contracts as per supply licence condition 22C.9³.

The potential costs of a successful bid following individual SOLR events are opaque to suppliers (excluding the appointee) until the claim is eventually submitted. Information released by Ofgem following a number of SOLR appointments indicates significant variation to the degree successful appointees intend to access the levy to reclaim costs. Insofar as Ofgem describes the impact on fixed tariffs as it '*constitutes a lower level of risk and one that suppliers should be able to manage*',⁴ this level of risk is not quantified and cannot be reliably predicted by suppliers.

Given the unprecedented level of supplier failures in 2018 (into 2019) and the scope for significant material claims which will follow (with the potential to exceed £80m, by broad media estimates) this behoves Ofgem to collate an accessible breakdown of costs that suppliers, and subsequently consumers, are facing from 1 April 2020. Under these proposals such costs cannot be factored into tariff pricing strategies in advance (and this will disproportionately impact suppliers with a large proportion of customers on fixed tariffs), Ofgem runs the risk of contributing to further supplier failures.

The lack of cost transparency created by these proposed changes, from the source and timing of the initial cost value (the initial triggering of a claim upon the levy by a SOLR appointee), to whether a DNO chooses to utilise the provision, creates significant uncertainty for suppliers. This uncertainty is compounded by the short notice period (of increases) afforded to suppliers, and the other issues raised in this response.

³ 22C.9 Without prejudice to paragraph 22C.5 or paragraph 22C.7, in relation to any Fixed Term Supply Contract, the licensee must not:

(a) increase the Charges for the Supply of Electricity (including, but not limited to, by making any reduction in the amount of a Discount that is directly applied to a Unit Rate or Standing Charge); or
(b) unilaterally vary any other terms and conditions in any way which is to the disadvantage of a Domestic Customer.

⁴ Statutory Consultation – page 5.

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 Mark Hatton on 07875 110832, or myself.

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

38B. Treatment of payment claims for last-resort supply where Valid Claim is received on or after 31 March 2019

Materiality Threshold –

EDF Energy agrees with Ofgem's updated position in this statutory consultation that the 'Materiality Threshold' should be a defined term in the licence. We note the inclusion of the reference to the price table 'Appendix 1' in 38B.11 in this regard. However, Ofgem should include the specific methodology which underpins the calculation of these values to ensure certainty as to forecast values is maintained, should this licence change endure for a significant period. Additionally, we would welcome further clarity regarding the application of 'Excess Specified Amount', and how this interacts with the Materiality Threshold.

Ofgem proposed text:

38B.7 Subject to paragraphs 38B.5 and 38B.6 of this condition, the Excess Specified Amount will equate to the aggregate value of Valid Claims received in a Regulatory Year that would cause the Materiality Threshold in any single Regulatory Year to be breached.

We note the Excess Specified Amount is defined as the aggregate value of Valid Claims which would breach the Materiality Threshold, and that the value of these claims would be recovered via the derogation path described in 38B.5 and 38.6. To clarify, where a number of valid claims are received in the regulatory year for which (the aggregate value) of these claims is less than the Materiality Threshold, the value of claims under that threshold would be recovered via pass-through arrangements (described in CRC 2B. Calculation of Allowed Pass-Through Items). For an additional claim in the same year that, when taken cumulatively with the existing claims, breaches the Threshold, it would only be the value of the latter claim which would be recovered via the derogation path.

By allowing an entire valid claim value (or aggregated multiple claims) to progress via derogation, a sum will commence being recovered from suppliers at short notice which could significantly exceed the cost over the threshold the DNO would otherwise bear.

The justification supporting the Materiality Threshold supports an explicit point at which the risk becomes intolerable for DNOs, derogation for a short notice increase to network charges should only apply for the proportion of the aggregated value of all valid claims (for the relevant regulatory year) which exceeds the threshold. This method will align to the cumulative effect of the separate claims principle as described in 38B.4⁵, and answers

⁵ Ofgem proposed text: 38B.4 Where the licensee makes payments in respect of more than one Valid Claim within the Regulatory Year t, SLRA_t (as defined in CRC 2B, Calculation of Allowed PassThrough Items) shall be treated as a single aggregated figure representing the total value of

the issues faced by DNOs in a manner proportionate to the Materiality Threshold. To transfer the burden of cost (to suppliers and consumers) for an entire valid claim, or the aggregated value of several or all valid claims received in a regulatory year, clearly does not proportionately balance risk between parties in the way Ofgem has described as its objective.

Note: with regard to measures for DNOs to address over/under recovery of SOLR costs in the next Regulatory Year (following the first year of recovery), by current provisions, suppliers are only afforded 40 days' notice of a change to network charges. Ofgem should consider the effect of this circumstance in any forthcoming impact assessment.

EDF Energy
February 2019

payments made to all Claimants in the Regulatory Year t, excluding Valid Claims subject to paragraph 38B.9 of this condition.