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Dear Vlada Petuchaite

Supplier Licensing Review: Ongoing requirements and exit arrangements

EDF Energy 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, 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 Energy is committed to 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 Energy fully supports Ofgem conducting a review of its approach to licensing and its ongoing scrutiny and oversight of suppliers. Changes to Ofgem's licensing approach need to be targeted and proportionate to ensure consumers are better protected and risks are minimised for existing suppliers. The proposals should also improve Ofgem's market oversight, promote higher financial and risk management standards, and ensure there are improved arrangements for managing market exit.

We agree that strengthening ongoing supplier arrangements will build on the progress that Ofgem has already made with entry requirements, and we fully support the regulatory outcomes which Ofgem wishes to achieve through the proposals in this consultation. All market participants must provide customers with an appropriate level of customer service and support, and their business models should not be able to put undue risks on the wider market and other participants. Market participants who create risks should bear the associated costs, and the regulatory framework should seek to minimise the risk of market exits that leave large customer credit balances and policy costs owing.

There have been a significant number of supplier failures resulting in customer disruption and cost mutualisation over the last two years. In these cases, customers who have been supplied by the failed supplier, often on very low prices, are in effect cross-subsidised by other customers through the mutualisation of unpaid policy costs and reimbursement of credit balances. This is manifestly unfair, and should be addressed as a matter of urgency. While we welcome innovation and

competition in energy supply, and do not wish to see excessive barriers to entry and operation, the sustained pricing of tariffs below cost is causing detriment to consumers, increasing costs for financially sound and responsible suppliers, and damaging the reputation of the industry as a whole.

We note that the proposals in this consultation will not ensure that all such risks are fully covered by suppliers who then may fail. For mutualisation costs, only 50% of credit balances are proposed to be covered and an undefined proportion of policy costs. However, if implemented effectively the proposed package of reforms will reduce the impact of disorderly market exits on consumers and the wider market and are therefore an important first step. Once these have been implemented then a further review should take place in 12 months to determine whether additional action is required.

There are some aspects of the proposals where we recommend that Ofgem reconsiders the approach, as an alternative course of action would achieve the desired outcomes more effectively. In particular, we recommend that further consideration is given to the detail of the proposals around a living will, operational capability principles and requirements for independent audit.

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 Lisa Lindstedt or myself.

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

Yours sincerely

R. Beresford

Rebecca Beresford
Head of Customers Policy and Regulation

Attachment

Supplier Licensing Review: Ongoing requirements and exit

EDF Energy's response to your questions

Q1. Do you think the proposed package of reforms will help to reduce the likelihood of disorderly market exits, and the disruption caused for consumers and the wider market when suppliers fail? Are there other actions you consider we should take to help achieve these aims?

Yes, the proposed package of reforms is a step in the right direction in reducing the negative impacts on customers and the wider market when suppliers fail.

In a market with such a large number of suppliers, EDF Energy does not believe that disorderly market exit can be completely mitigated against, and the proposed package of reforms will not achieve this. However, if effectively implemented they will help to ensure that those suppliers who are not suitably prepared, resourced and fit to operate improve their operations, or face prompt action from Ofgem to mitigate the risk they present for customers and the wider market.

All market participants must provide customers with an appropriate level of customer service and support, and their business models should not be able to put undue risks on the wider market and other participants. Market participants who create risks should bear the associated costs, and the regulatory framework should seek to minimise the risk of market exits that leave large customer credit balances and policy costs owing.

We note that the proposals in this consultation will not ensure that all such risks are fully covered by suppliers who then may fail. For mutualisation costs, only 50% of credit balances are proposed to be covered and an undefined proportion of policy costs. However, if implemented effectively the proposed package of reforms will reduce the impact of disorderly market exits on consumers and the wider market and are therefore an important first step. Once these have been implemented then a further review should take place in 12 months to determine whether additional action is required.

We recognise that increased requirements have now been put in place for market entry; however these have been put in place after a very large number of suppliers have entered the market.

Therefore, effective and rigorous enforcement of this new package of measures for ongoing monitoring is required to protect the interests of customers and the wider market.

Q2. Do you agree with the outputs of our impact assessment?

Overall the impact assessment looks comprehensive and appropriately reflects the likely impacts to consumers. We agree that the primary area of concern is around suppliers who go through rapid periods of growth, such that proportionate changes are required to ensure that suppliers bear the cost of the risk they impose on the system and that consumers remain appropriately protected.

Q3. What further quantitative data can industry provide to inform the costs and benefits of the impact assessment, particularly for cost mutualisation protections?

EDF Energy does not have further quantitive data to inform the costs and benefits of the impact assessment. The costs associated with the policy proposals will vary depending on individual supplier's business models. However, to minimise the costs involved in implementing these proposals it is important that any additional measures placed on individual suppliers reflect the risks they impose on the system. Financially stable suppliers, who can demonstrate a robust level of creditworthiness via a credit rating for example, should not be burdened with additional unnecessary costs through mutualisation protections. Ofgem's impact assessment and consideration of costs is reasonable and we acknowledge that for some individual parties costs may be higher. However, any such costs to deliver these proposals are legitimate costs which should be borne by an efficient supplier operating in the retail energy market and should therefore be reflected in the energy price cap.

Q4. Do you agree with the assumptions used to calculate the costs and benefits in our impact assessment? If not, please provide evidence to support further refinement.

The assumptions used to calculate the costs and benefits look reasonable.

Q5. Do you agree with our proposed option to cost mutualisation protections? Are there other methods of implementing this proposed option? Please provide an explanation and, if possible any evidence, to support your position.

We fully support implementing cost mutualisation protections for 50% of credit balances and that this is also the proportion that should be implemented for relevant policy costs. The policy costs that should be included are for schemes which do not have credit protection provisions in place, including the Renewables Obligation (RO). However, the capacity market mechanism which already has credit cover arrangements for the supplier obligation element does not need such protections.

50% is a reasonable proportion to initially protect and, once implemented, Ofgem should keep this under review to assess the costs involved and whether it would be proportionate to increase this over time.

The flexibility of a 'menu' of options that suppliers can choose from to implement the protections is sensible. Protections should be proportionate to the risks individual suppliers place on the system. Such protections may include letters of credit or bank guarantees, insurance schemes or parent company guarantees if provided by a guarantor with an acceptable minimum credit rating. Cash is a further option, either held in escrow, or to reduce costs, held by a government backed entity. We consider these to be tangible forms of protection.

However, factoring payments in to cash flow forecasts is not an acceptable form of credit protection. This is basic financial and business planning that should be done as a matter of course by all suppliers.

Industry codes such as the Connection and Use of System Code, the Distribution Connection and Use of System Agreement and the Uniform Network Code already have a concept of assigning a free credit line to suppliers, based on a minimum credit rating of BB-. This should be an acceptable level of credit rating for a supplier, above which it does not need to provide alternative cost protection. Ofgem should take a risk-based approach to avoid imposing unnecessary costs and financial constraints on suppliers that are already financially disciplined, and therefore avoid imposing greater than necessary costs on consumers. Only suppliers that present a material risk based on their creditworthiness should require a tangible form of protection.

In introducing such measures, Ofgem will need to issue guidance as to how the credit balance should be determined, including for instance, how unbilled energy is treated and how often credit balances are recalculated and required protections adjusted. A quarterly review will ensure suppliers have adequate protections in place. The calculation should be transparent so suppliers can plan accordingly. For the RO, Ofgem also needs to consider whether ROCs (Renewable Obligation Certificates) already delivered to a supplier and held in their registry could be netted against the required protection value or not.

In terms of an implementation timescale, 6 months would be appropriate.

Q6. Do you agree with our proposal to introduce new milestone assessments for suppliers? Do you think the milestones we have proposed and the factors we intend to assess are the right ones? Are there additional factors we should consider to help us to identify where suppliers' may be in financial difficulty?

Yes, we support Ofgem's proposal for new milestone assessments and that the assessments are set to take place at key customer threshold numbers. Ofgem should have a greater and more effective role in monitoring the financial resilience of all suppliers on an ongoing basis.

Ofgem's impact assessment highlights that the risks to consumers are much higher from those suppliers with high growth rates across a short period of time, in terms of quality of service and risk of failure. The milestone assessments will provide ongoing assurance, that suppliers are fit for purpose and have a credible plan in place when certain regulatory obligations start to apply.

For these reasons, the final milestone portfolio number should be 500,000 rather than 800,000. We also agree that Ofgem should look to undertake 'dynamic' assessments of any supplier who is showing signs of financial difficulty. There are many factors that may indicate this is the case and we agree that Ofgem should not look to set out specific criteria for any such assessment.

However, to ensure this is effective suppliers should inform Ofgem when they expect to pass such milestones so that assessments can take place in advance. Otherwise, consumer detriment is risked by Ofgem only being aware that key regulatory protections are not in place, after the time they should have already been implemented. This would also allow fast growing suppliers to undertake assessments for multiple milestones at the same time allowing for efficiencies for such suppliers and Ofgem.

Ofgem should also clarify how they would limit a supplier taking on new customers to avoid breaching the threshold before any milestone assessment is performed and how this would be consistent with the universal service obligation, and specifically for domestic consumers, with Supply Licence Condition 22 (Duty to offer and supply under Domestic Supply Contract).

Q7. Do you agree with our proposal to introduce an ongoing fit and proper requirement? Are there additional factors, other than the ones we have outlined, that you believe suppliers should assess in conducting checks?

We are supportive of the proposal of an ongoing 'fit and proper' requirement. Such a test is already part of the new entrant process checks and it would be appropriate to apply the same standards as an ongoing requirement. The definition of a person with 'significant management responsibility or influence' is open to interpretation and we request additional guidance as to which individuals this would cover.

The proposed 'open and cooperative principle' to disclose anything relating to the licensee the Authority would reasonably expect notice of is very broad and subjective. This principle needs to be defined more clearly, with some materiality threshold such as linking to actual or potential material detriment to consumers. Ofgem can already make use of its powers under Supply Licence Condition 5, to take action with suppliers who do not constructively engage and ignore mandatory information requests; therefore a new licence condition has not been justified. To ensure the objective of this requirement is clear we would recommend that 'cooperative' is replaced by 'constructive' or 'transparent'.

Q8. Do you agree with our proposal to require suppliers to produce living wills? What do you think we should include as minimum criteria for living will content?

We do not support the proposal to require suppliers to produce living wills. In the event of supplier administration, the administrators have wide powers, including to cancel contracts and to direct the affairs of the company they are administering. As Ofgem does not regulate administrators, it is difficult to see how Ofgem would be able to force particular actions to be taken. Further, the administrator's role is to rescue the company or secure the best outcome for its creditors. This duty

may conflict with the proposals in the living will. An administrator may consider that they cannot act so as to favour the supplier's residential supply consumers, where funds are required to pay a service provider whose service is needed to keep the suppler going, or to pay a secured creditor. Ofgem should explain the legal argument behind the proposal of living wills.

However, we do support the objective of ensuring more transparency over a supplier's systems and other relevant information which would be helpful for Ofgem, and a winning SoLR supplier, in the event of supplier failure. This could be more readily achieved by requiring all suppliers to provide such information at regular intervals to Ofgem. An initial basis for this would be the operational aspects of the current SoLR Request for Information (RFI) and the data that Ofgem requires from failed suppliers currently. By having to evidence that this is retained, in an appropriate format that can be easily accessed by Ofgem, as an ongoing requirement, then the legal issues outlined above around a living will would not be relevant. This would be a requirement on licensed suppliers and could be accessed prior to licenses being revoked.

In addition, greater information on suppliers' financial performance would support Ofgem's wider objectives. Therefore, the current requirement to provide audited segmented accounts, which is currently placed on a narrow range of suppliers, should be extended to a larger subset of licensed suppliers.

Q9. Do you agree with our proposed scope for independent audits? Please provide rationale to support your view.

We agree with the proposal to require an independent audit to be undertaken, but this should only be in exceptional circumstances to ensure this is used in a proportionate way. Therefore, this restraint should be reflected in the licence wording to give suppliers confidence that this will not become a regular request from Ofgem.

Q10. Do you agree with the near terms steps we propose to take to improve consumers' experience of supplier failures? Are there other steps you think we should be taking?

We agree that consumers should be protected from undesirable recovery practices undertaken by administrators. Administrators have a responsibility to be aware that some consumers may be financially vulnerable and to act in a way that is appropriate to the consumer's particular circumstances. However, we do not think that the proposals in this consultation will have any legal impact on administrator's debt recovery methods. Back billing constraints are already included in terms and conditions, but some administrators continue to ignore them. Ofgem recognises they are limited over how administrators work in the recent open letter, published on 5 November 2019[1]. We recommend that Ofgem should instead work with the Financial Conduct Authority and Insolvency Service to take action where administrators are causing consumer detriment. We would

[1] Open letter to insolvency practitioners appointed to failed Energy Supply companies published 5 November 2019

like to understand how this could be achieved on a consistent basis, in order that all consumers receive comparable levels of protection against such practices.

Supply Licence Condition (SLC) 8.5(c) is clear that after the SoLR takes effect, the affected consumers are no longer in contract with the insolvent supplier and are instead in contract (a deemed contract) with their new supplier. This being the case, Ofgem would need to ensure suppliers, consumers and insolvency practitioners agree that terms in a now terminated contract continue to apply.

Paragraph 4 of Schedule B1 to the Enterprise Act 2002 states, *the administrator of a company must perform their functions as quickly and efficiently as is reasonably practicable*. This duty may not be fully consistent with SLC 27.6(ii) and 27.8, which seek to allow consumers time to pay debts based on their financial circumstances. We would question whether keeping active an insolvent company which would otherwise be dissolved, while consumers pay off debts is consistent with the policy on insolvency, which requires insolvency processes to be swift.

Q11. Do you think there is merit in taking forward further actions in relation to portfolio splitting or trade sales? What are your views of the benefits of these steps? Are there any potential difficulties you can foresee?

Whilst recognising that portfolio splitting could allow some smaller suppliers to submit SoLR bids, achieving this in practice would be overly complex. Facilitating the SoLR requires the support of various central service providers. Given the speed at which action needs to be taken and the absence of rules governing the role of these parties, they are inclined to make the changes to industry arrangements in the quickest and most straight forward way possible. Requiring these service providers to interact with multiple suppliers, will require more specific rules to govern how the various actions are delivered, which supplier has access to the failed supplier industry IDs and the priority of work, if all tasks cannot be delivered at the same time. Industry arrangements are delivered using systems which utilise participant ID's and technical coding. Taking a single ID and splitting it multiple ways is beyond what is currently technically achievable by industry parties.

There is a particular issue with the interaction and touchpoints in the gas supplier and shipper relationship. When a supplier who is in contract with a shipper fails, the shipper will remain and the SoLR will need to work with the shipper to ensure continuity of supply. There are no industry rules or arrangements to manage that discussion and so negotiations can be drawn out. This may be additionally complex if these discussions have to occur multiple times due to the shipper engaging several suppliers.

On the commencement of a SoLR, Xoserve cancels the supplier ID in their system which is unhelpful and means that individual suppliers may then need to set up new IDs to manage the consumers. Increasing the number of parties involved in the SoLR, could increase the administrative burden on suppliers and industry parties.

Ofgem states that their preference is for a commercial solution, such as a trade sale, to avoid intervention in the form of SoLR. It is not clear how Ofgem would identify that the supplier is going to fail or not and take action with these proposals, such as requiring prior approval for consumer book sales. There would also be additional complexities if a trade sale was already in progress.

Ofgem should also consider the potential purchasing supplier, who may have made operational and commercial decisions on the basis a sale would proceed with the expectation of increased consumer numbers via the trade sale. Blocking that sale could then detrimentally impact the potential purchaser. Intervention to a trade sale may also increase the number of failed suppliers, who would otherwise have survived post trade sale and affecting consumers who could have been retained.

Q12. Do you think our draft supply licence conditions reflect policy intent?

To some extent, the supply licence drafting is very broad and needs to be more clearly defined.

The operational capability principle is wide and subjective in terms of '*serve each of its Customers*'. This should be more precisely stated, such as a requirement to serve each of its *'Customers' reasonably and fairly'*.

The proposed new licensing conditions for the ongoing '*fit and proper'* requirement should provide more flexibility such as an *"all reasonable checks"* requirement and for the proposed Condition 1.2 it would be useful to have a list of examples similar to the '*fit and proper'* person considerations, though an exhaustive list would be preferable.

The definition of *'Senior Management Responsibility or Influence'* should be clarified as organisations will have different organisational structures and so there will be uncertainty as to who should be included. This should be defined based on their responsibilities within the organisation.

EDF Energy
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