Letter to Chair of BEIS Select Committee

Darren Jones MP
Chair, BEIS Select Committee
House of Commons
London
SW1A 0AA

2nd February 2022

Dear Mr Jones

I am writing to share EDF's written evidence to your Committee's inquiry into energy pricing and the future of the energy market, and to express my profound concern about the critical situation facing consumers and suppliers.

Until now customers have been insulated from the effects of the crisis by Ofgem's Standard Variable Tariff price cap, and the majority of rapidly increasing costs have been shouldered by the remaining suppliers in the energy retail market. However, on 3 February the regulator is expected to announce an increase of around £600 to the cap from April. Without action, further cost increases this winter mean the cap is expected to rise again to £2000 in October, doubling from last winter. These increases are simply unaffordable for vulnerable households who are already struggling to pay their bills.

Whilst EDF, and indeed all suppliers, have a duty of care to support the welfare of their customers, the scale of this affordability problem is now so significant that intervention from Government is required.

Whilst in recent weeks the UK Government, and the regulator, have begun to consider interventions, tangible solutions must now be delivered quickly. Interventions must not only include targeted support to help customers facing unprecedented bill increases, but must also include reform of the energy retail market to protect suppliers, and consumers, from recurring issues.

As you will appreciate, this issue is developing very quickly but the evidence we have provided is an accurate reflection of EDF's views of the crisis at the time of writing. This includes actions we believe might help to minimise the damage caused by this crisis, and what steps should be taken to prevent a similar crisis from reoccurring.

We are here to support your Committee in this important inquiry over the coming months. We would be very keen to expand on our recommendations in any oral evidence sessions you may be arranging.

Yours sincerely,

Philippe Commaret
Managing Director
Customers

EDF RESPONSE TO THE HOUSE OF COMMONS BUSINESS, ENERGY AND INDUSTRIAL STRATEGY COMMITTEE INQUIRY INTO ENERGY PRICING AND THE FUTURE OF THE ENERGY MARKET

2 February 2022

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EDF in the UK

- EDF is Britain's biggest generator of electricity, meeting around one-fifth of the country's demand using low carbon nuclear and renewable power.
- We are one of the largest suppliers to British homes and businesses with over six million electricity and gas customer accounts.
- In 2021 we stepped in to ensure the supply of almost 600,000 customers after their suppliers failed: Green Network Energy (360,000 customers), Utility Point (220,000 customers), and Zog Energy (11,700 customers).
- We were the first company to introduce a fund specifically to support customers struggling to pay their bills. Over 20 years, it has provided more than more than £50 million of debt relief and purchases of energy efficiency white goods for our most vulnerable customers. We partner with Citizens Advice, National Energy Action, Scope, Macmillan Cancer Support, Shine and others to maximise our impact. Last year we also committed £3.7m to third party organisations to maximise the support available to customers. Our partnerships include Citizens Advice Plymouth, National Energy Action, Income Max, MacMillan Cancer Support and SHINE.

Key points

- Residential and business energy consumers face historically high energy price increases over the coming 18 months, driven primarily by rapid increases in wholesale gas prices passing through to bills. Consumers will be asked to shoulder an unprecedented, and for many, unbearable cost burden which is exacerbated by successive policy and regulatory failures in the energy market at a time when many can least afford to.
- The increase in the Standard Variable Price Cap in April could be as much as £600, and by October, the cap could reach £2000, almost twice as much as the levels seen last winter.
- EDF analysis shows these increases will disproportionately impact poorer families. For the 10% of British households with lowest incomes, £1 in every £7 will be spent on energy next year.
- The rapid failure of 31 suppliers since the beginning of 2021 is expected to cost around £2.5 billion. In addition, Bulb - the largest supplier failure to date with 1.6 million customers – entered a Special Administration Regime in November which is expected to cost £1.7 billion. Without intervention, these costs are due to be passed onto consumers from April 2022, further impacting their cost of living.
- Without action from policymakers, UK consumers face significantly increased rates of fuel poverty and financial difficulty
- While short term actions can provide some relief to customers in 2022/3, longer term changes are needed to ensure the energy industry is able to support delivery of net zero. These includes reforms to improve the stability and resilience of the retail market.

The energy crisis: what went wrong?

Decades of increasing dependence on gas left consumers vulnerable to an historic spike in wholesale gas prices. This price volatility exposed weaknesses in the structure, and regulation, of the energy retail market which resulted in 31 supplier failures and leaving consumers to pick up the cost

The UK has become too dependent on gas. Rising global gas prices have a direct impact on gas and electricity bills

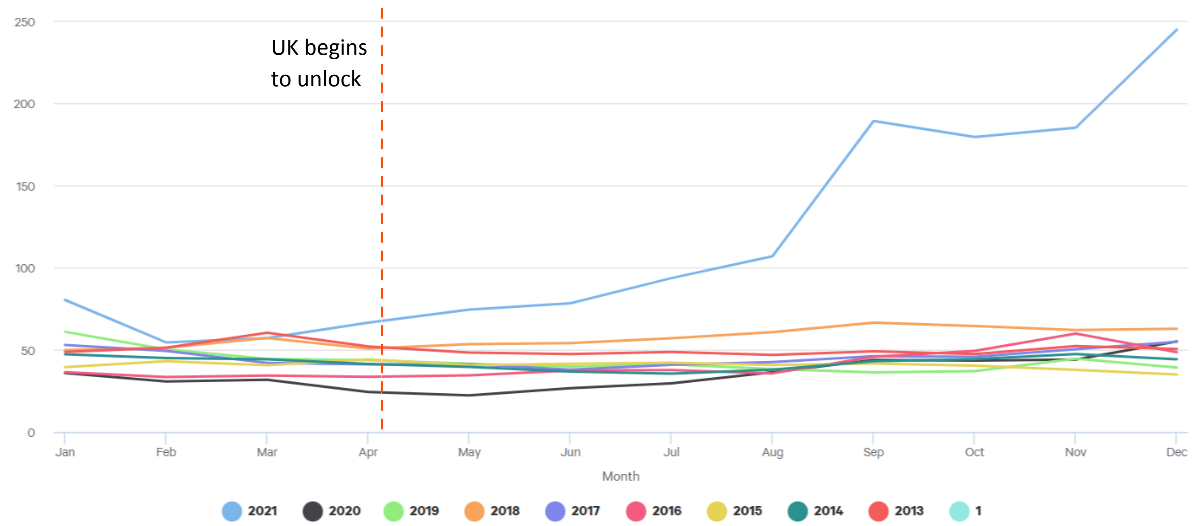
- The UK has significantly increased its reliance on gas to generate electricity over the last three decades:
  - In 1990, gas accounted for 0.4 TWh of UK electricity generation and increased by almost 28000% to 111.4TWh in 2020. In 2020, 35% of UK electricity was generated from gas, more than any other source.[1]
  - This increase in reliance on gas has been the result of highly polluting, but firm, coal power generation declining whilst low-carbon, but weather-dependant, renewable generation sources increased. The UK's existing nuclear fleet is due to come offline in the coming years and recorded its lowest output for two decades in 2020. With only one new nuclear power station under construction, this means that any shortfall in wind and nuclear generation must be covered by gas.

- Whilst gas is the primary source of electricity generation, it is also the primary source of heat for the vast majority (85%) of UK homes which rely on gas boilers.[2]

- Because of the UK's over-reliance on gas, any increases in wholesale cost feed through rapidly into customers' bills.

- As stated by Ofgem, in 2021 wholesale costs of gas rose by over 500% in under a year[3]. Volatility in the wholesale gas market has been caused by several factors:
  - Geopolitical issues, particularly in Eastern Europe, have severely limited the supply of gas to Europe at a time when demand has increased as economies emerge from Covid-19 related lockdowns.
  - Gas stores within the UK have significantly reduced.
  - Wind electricity generation was generally lower in the Summer and Autumn of 2021, increasing demand for gas-generation.
  - Routine maintenance of nuclear generation also increased demand for gas generation.

Fig.1 – Increasing gas prices in 2021 (YOY comparison)



Source - NordPool

The design and regulation of Britain's energy retail market have enhanced the problems

- **The wholesale price spike exposed structural fragility that exists across the UK's energy retail market**. EDF and other suppliers – large and small – have been raising concerns about these issues for several years.

- **For some time, there has been too great a focus on switching, with low barriers to entry and a failure to ensure all market participants were operating responsible, long term hedging strategies.** Retail market policy over the last decade has been focussed on enabling new suppliers to enter the market, encouraging consumers through price comparison websites to frequently switch between suppliers in pursuit of a better deal. A price cap was introduced in 2019 to ensure that suppliers were not able to charge unfairly high prices to less engaged customers on default tariffs, however the consequences of maintaining a parallel competitive market that customers could choose to move in and out of was not fully considered.

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[1] Source – BEIS 'UK Energy in Brief 2021', p.28
[2] Source – National Grid 'Future Energy Scenarios 2021', p.52
[3] Source Ofgem 'Raft of new measures to boost the financial resilience of the energy sector'

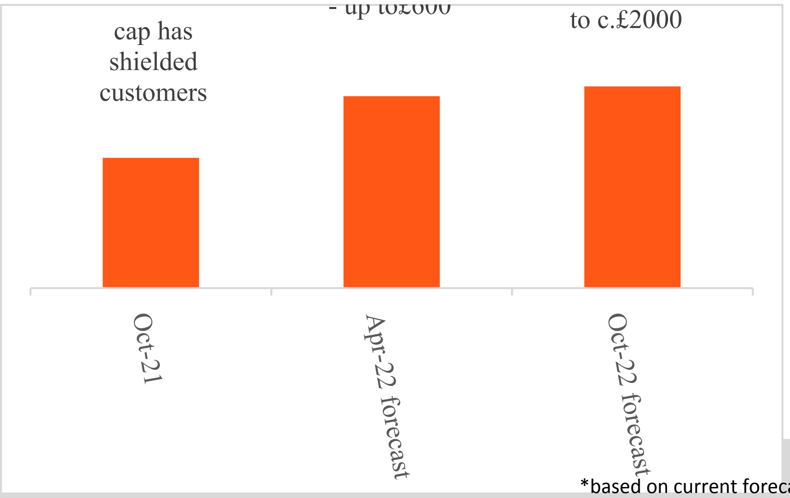
- The **pressure to compete to win customers led to the operational practices of some suppliers being more responsible than others**, with many thinly capitalised market entrants failing to implement an effective hedging strategy and preferring to focus on short term profit over long term customer relationships. Failing to properly hedge against rapidly increasing wholesale gas prices meant suppliers were unable to honour customer contracts and found themselves without enough cash to keep their businesses operating.

- **The failure to properly scrutinise supplier behaviour was so significant that the owners of some failed suppliers were able to sell off the limited hedges they had purchased at a profit only to then declare bankruptcy, leaving consumers to cover the costs of repurchasing the energy and protecting consumers.**
    - While many small suppliers did and do operate effective and robust hedging strategies, as far back as 2016 the CMA concluded that: "Large Energy firms… generally hedged more volume further ahead than independent operators."[4]

- **Current market regulation also provides limited controls on how suppliers manage customer credit balances**, allowing some to build up customer credit balances to fund their business growth, in the knowledge that in the event of bankruptcy they would be mutualised across the industry.

- **Ofgem's SVT price cap has insulated customers from most of the market volatility and had delayed the impact of higher wholesale prices being passed through to bills, but it was designed to protect disengaged consumers, not to provide a solution to affordability. As such, its current form presents unmanageable and unreasonable risks** to both:
    - Consumers who are not provided an accurate reflection of the costs of the energy they are consuming, which could then be incurred at a later date (as evidenced by the large increases to the price cap expected in 2022), and;
    - Suppliers, who are prevented from being able to fairly charge the costs they have incurred to source energy, forcing them to operate at a financial loss.

Fig.2 – SVT Cap Forecast



*based on current forecasts of costs

The energy crisis: What

EDF has proposed solutions to help consumers manage the financial difficulty of the next 18 months, while determining the future design of the market. Options are available to help but action needs to be taken quickly.

Several European governments have already introduced measures to support customers through this winter. A summary of these measures is included in the appendix.

Immediate measures

EDF recommends the following measures to address the financial detriment of customers. Any changes must:

a) maintain the overall commitment to the net zero transition
b) be simple, not only to implement quickly, but also to limit confusion at a difficult time for customers

1. **Provide immediate, targeted support for financially vulnerable households to help with energy costs for those who need it most:**

   I. A targeted rebate may be possible given high energy bills may have generated more revenue than usual from taxes, carbon permits/other sources.

[4] Source – CMA 'Energy Market Investigation Final Report', p. 321

II. For example, VAT receipts from residential energy bills are expected to be around £170 million higher this winter than last. If these additional receipts were distributed amongst Warm Home Discount recipients - some 2.2 million households – that would provide an immediate rebate of around £80 per household.

III. If energy prices remain high then associated tax revenues will also remain high, and this model could be repeated to provide a further payment to financially vulnerable customers at a later date.

2. The Government should consider how the costs of failed suppliers should be recovered

I. Since the beginning of 2021, the cost of supplier failure is estimated to be around £2.5 billion. In addition, the cost of the Special Administration Regime for Bulb's 1.6 million customers is not yet known, but could be a further £1.7 billion. According to current regulations, the SoLR costs will be built into Ofgem's price cap and recovered from April 2022 (already approved costs are expected to add £60 on every customer account from April). There is currently no visibility on whether the Bulb costs will ultimately be recovered from customers or absorbed by taxpayers.

II. Whilst suppliers must be able to quickly claim back the fair costs they have already incurred through the SoLR process, passing those costs onto consumers at a time when energy bills are already expected to sharply rise would simply exacerbate the affordability crisis for customers.

III. The Government should consider how to avoid these costs impacting customer bills, particularly in the short term. This could include deferring recovery of the costs of the SoLR process and spreading them over a longer period.

IV. Furthermore, we ask for the Government to release more details about Bulb's Special Administration Regime as soon as possible, including how Bulb's 1.6 million customers will be transferred to a new supplier. As yet, other suppliers and customers have no visibility of the scale of potential costs, or the intended process and timeline for any recovery.

3. HMG should consider broader mechanisms to protect all households facing sharp increases to energy bills in 2022

I. Stripping away taxes and green levies from bills, and shifting them onto general taxation, could save all energy customers around £182 (VAT £90, £17 FiT, £75 Renewables Obligation).

II. This would still leave customers facing a large increase on bills of over £350 and the Treasury should consider the potential impacts of this increase on inflation and affordability.

III. It is for the Government to decide whether broader interventions should also be targeted to maximise the support for those most in need, and to support Net Zero.

IV. However, any intervention:

- Needs to be deliverable quickly and to the benefit of customers. This includes being Treasury funded to minimise any potential costs for consumers.
- Must not result in the hinderance or suspension of current programme delivery that are key to our net zero ambition, such as the Energy Company Obligation (see below).
- Must be compatible with the reforms required to the price cap methodology (see below)

4. For a temporary period, Ofgem should suspend new customer only deals so that loyal customers are not picking up additional costs. A following review would be required to analyse impacts.

5. There should be closer scrutiny of Third Party Intermediaries, including Price Comparison Websites, to ensure consumers are adequately protected

I. Price comparison websites have played a part in the energy crisis by directing savvy, engaged consumers to suppliers who are following unsustainable pricing practices. This is to the detriment of disengaged (and often vulnerable) consumers who are left paying for the costs of those failed suppliers including through the mutualisation of Supplier of Last Resort and Renewables Obligation costs..

II. Price comparison websites can take inconsistent approaches to comparing tariffs of differing lengths and from different suppliers. Clear guidance and consistent methodologies are required to ensure customers are able to make more informed decisions.

III. BEIS should progress the work it has started to consider the appropriate regulatory framework for Third Party Intermediaries in future, including Price Comparison Websites and Auto-switching services.

6. Urgently reform the price cap to continue protecting customers whilst delivering a more sustainable, and reliable, energy market

I. The current market crisis has exposed weaknesses in the current price cap which must be resolved, particularly given wholesale price volatility is expected to continue.

- For example, the design of the current wholesale allowance methodology in the price cap means suppliers must hedge 8 months in advance, exposing them to large volume risks arising from increasing prices and falling prices, without offering any additional value for customers.

- This creates artificial price differential compared to fixed price tariffs, providing a free option for engaged, switching customers to switch between SVT and fixed tariffs in comparison to other disengaged customers, who are often more vulnerable, exacerbating problems when the market sees steep changes in price.

II. Ofgem is already consulting on changes that could be introduced as soon as October 2022. However hedging for the next price cap period (October 2022 – January 2023) has already begun, so while it's critical that much needed changes are introduced, suppliers must not be not put at any disadvantage as a result of the period of uncertainty we are currently in.

7. More fundamental changes to the framework of price regulation are a matter for government, and will require legislative action.**More strongly encourage take up of smart meters and energy efficiency** which can help customers reduce their energy use to better protect them from further cost increases.

I. As mentioned above, the ECO scheme should be protected in the event of any cost interventions. Continued improvement of the energy efficiency of British housing stock will limit the impact of future of wholesale cost increases on consumers and is a prerequisite for the electrification of heat.

8. Better monitoring of the financial resilience of market participants

I. We are supportive of Ofgem's ongoing review of the introduction of regulatory checks against new market entrants and those participating in the market to ensure practices are sustainable.

II. It is important that these assessments are well designed and robust to provide confidence that suppliers are fit for purpose and have credible plans in place to meet their regulatory obligations.

III. Ofgem must be able to take action promptly if their monitoring of suppliers identifies any areas of concern. Interventions could include temporary restrictions on a supplier's ability to acquire new customers, until such time as any issues had been resolved.

Longer term changes to the UK energy market

We strongly encourage continued collaboration between policymakers, existing industry participants and other stakeholders to make progress on a vision for a future retail market which is resilient, and importantly, is fit for Net Zero.

9. We encourage BEIS to include the role of price regulation in their current review of the Energy Retail Market
   a. Whilst we welcome Ofgem's recent consultation on adapting the current price cap methodology to provide resilience in a volatile market, Ofgem is constrained in its ability to act by the Tariff Cap Act legislation. Therefore, any amendments they can make are limited and are unlikely to fully correct flaws in the design of the current default tariff cap arrangements.
   b. Consideration of the longer term future of price regulation in the retail market should include a comprehensive debate on the costs of net zero, and how these could be balanced fairly between customers and taxpayers. The current approach of policy costs being heavily weighted towards electricity bills, rather than gas bills or taken into general taxation, is directly hindering essential progress towards decarbonisation of heating, for example.

10. BEIS should step away from proposals to introduce opt-in switching and the testing of opt-out switching
   a. The focus on switching between suppliers being a key measure of the competitiveness and success of the retail market has failed to protect consumers from the current crisis.
   b. Furthermore, BEIS proposals for an opt-in switching scheme, and the testing of opt-out switching, appear wholly incompatible with objectives for a future market where consumers are more engaged with decarbonisation of energy.

11. BEIS should continue to progress reforms around Low Carbon Claims made by suppliers to ensure that customers are given useful and accurate information to enable them to participate in achieving net zero
   - BEIS has already initiated this review and it would be disappointing if these improvements, which would benefit customers, were delayed.

12. Fundamentally, the UK must move away from gas powered generation and accelerate the development of renewables and nuclear.
   a. As highlighted by the current crisis, the UK's over-reliance on gas generation has created enormous risks to suppliers and customers which are compounded by International events. As it stands, the UK remains vulnerable to a reoccurrence of current events in the future.

b. Achieving the levels of energy security required means we must make progress on developing and financing for new nuclear power stations and continued investment in offshore and onshore wind and solar.

Appendix

Measures taken by other European governments

- **France**
  - Targeted additional rebates (€100 payment for 5.8m households already receiving 'energy cheque'
  - €100 additional payment to low earners (<£2k/month)
  - Gas price cap until end of '22 to protect consumers on floating rate contracts
  - Commitment to cap regulated electricity tariff increases in Feb '22 to 4%
- **Germany**
  - Reduction of EEG (Germany's renewables charge) from 6.5 to 3.7 cents / kWh from 1 Jan 2022; financed by the federal budget and revenue from the EU ETS
- **Spain**
  - Temporary VAT on electricity cut from 21% to 10% for those with <10kW 'contracted power'
  - Temporary excise duty on electricity cut to 0.5%
  - Cap on gas price reviews for regulated tariffs
  - Increased revenues (from €1.1bn to €2bn) from CO_2 emission allowance auctions used to finance electricity bill levies
  - Increasing social bonus (discount on electricity bills for >1.3m people) to vulnerable consumers from 25% to 60% and from 40% to 70% for severely vulnerable until end Q1'22; budget for thermal social bonus doubled in 2021 to €202.5m, up to €90 on average per vulnerable family. Ban on disconnecting vulnerable customers extended.
- **Portugal**
  - Reductions in network tariffs for households and industrials, with a slight reduction (~3%) in 'regulated tariffs' for households in 2022
- **Rep of Ireland**
  - One-off €100 payment to every household (14 Dec'21)
  - Income tax relief in 2022 at 30% of vouched expenses for electricity, heating and internet for days spent working from home