

**BEFORE THE COMPETITION AND MARKETS AUTHORITY
AN APPEAL UNDER SECTION 11A(1)(b) OF THE ELECTRICITY ACT 1989 AND SECTION
23B OF THE GAS ACT 1986**

UTILITA ENERGY LIMITED

Appellant

-and-

THE GAS AND ELECTRICITY MARKETS AUTHORITY

Respondent

-SUPPORTED BY-

EDF ENERGY CUSTOMERS LIMITED

**Application for Permission to Intervene in Energy
Licence Modification Appeal
("INTERVENTION NOTICE")**

*pursuant to Rule 10.5 of the CMA Energy Licence
Modification Appeals Rules ("CMA Rules")*

Intervener:

EDF Energy Customers Limited
90 Whitfield Street
London
England
W1T 4EZ

**Intervener's legal representatives
and address for service:**

Joe Souto
EDF Energy Customers Limited
90 Whitfield Street
London
England
W1T 4EZ
Joe.Souto@edfenergy.com
(with copies to
Keith.Jones@bakermckenzie.com &
Joanna.Ludlam@bakermckenzie.com)

Persons sent copies of this notice of intervention: An electronic copy of this Intervention Notice and accompanying documents has been sent to the persons listed under 'Contact details' in the respective Notices of Appeal.

EDF Energy Intervention Notice

1. INTRODUCTION AND SUMMARY

- 1.1 This is an Application for Permission to Intervene in an Energy Licence Modification Appeal (the "**Intervention**") by EDF Energy Customers Limited ("**EDFE**"). EDFE opposes the Appellant's appeal to the Gas and Electricity Markets Authority ("**Ofgem**")'s decision of 26 July 2023 to modify standard licence conditions ("**SLC**") 4B and 4D pursuant to s.11A(1)(b) of the Electricity Act 1989 ("**EA89**") (in respect of electricity supply licences) and s. 23(1)(b) of the Gas Act 1986 ("**GA86**") (in respect of gas supply licences) (the "**Decision**").
- 1.2 EDFE is applying to intervene in support of Ofgem and does not seek to duplicate or repeat points made in Ofgem's response to Utilita Energy Limited's ("**Utilita**") notice of appeal dated 21 September 2023 (the "**NoA**") (the "**Response**"). The purpose of the Intervention is to provide additional support to the Response in relation to certain aspects of the appeal based on EDFE's experience and expertise in energy supply.
- 1.3 EDFE supports the Decision to introduce a minimum capital requirement for energy suppliers and sees it as a proportionate and necessary measure that will help avoid supplier failure. This has been a material issue in the market and has caused significant loss and damage to industry participants and consumers for too long.
- 1.4 EDFE is well-positioned to assist the CMA in relation to the appeal on the basis that EDFE is:
 - (a) the UK's largest producer of low carbon electricity and a significant presence in the industry, with around six million electricity and gas customer accounts, including residential and business users. EDFE's experience means it is well placed to comment on the risk that all businesses in the sector face, including Utilita, given the wholesale price volatility.
 - (b) a stakeholder that participated in the consultations and development of the minimum capital requirements on suppliers. The CMA will be able to see how EDFE has engaged constructively with Ofgem's proposals, suggesting

alternatives, but recognising that what is being proposed is appropriate at this point in time.

- (c) directly impacted by the outcome of the appeal. EDFE was one of a number of suppliers that weathered the energy crisis and extreme price volatilities in 2021 and 2022 and has an interest in ensuring that regulatory measures promote higher financial and risk management standards in the energy market, minimising the risks and costs of supplier failures which are subsequently 'mutualised' across remaining suppliers.

1.5 The modifications to the SLC implemented by Ofgem, particularly the minimum capital requirements, will promote a healthy, well-functioning market that allows efficient and sustainable businesses to attain a fair margin and enable continued innovation and investment to benefit the interests of consumers whilst ensuring that relevant investors have "skin in the game" in the event of failure. They help ensure a level playing field whilst balancing the need to protect consumers and to promote competition.

1.6 EDFE has an interest in ensuring the modifications are implemented. If EDFE is not permitted to intervene then there is a risk that the CMA will not have the evidence of other industry players in relation to the Decision and certain assertions made by Utilita, in particular its assertion that its business model is without risk.

1.7 EDFE does not seek to address every ground of Utilita's appeal and, to date, has not had sight of the important expert evidence relied upon in the NoA. Conversely, EDFE seeks to assist the CMA where it is appropriate to do so based on the NoA itself. The Intervention is therefore focused on the following aspects of Utilita's appeal:

- (a) *The Capital Target is "wrong" as not being necessary – and does not achieve the Effect Stated by the Authority.* A Capital Target is necessary as all suppliers, including Utilita, operate with risk. EDFE views itself as a well-hedged conservative competitor. The risk arises as there is, at the very least, a volume risk. If customers use more or less energy than predicted and hedged for, then there will be a mismatch between revenues and costs, even with all customers on standard variable tariffs ("SVT"). This can be material. For instance, in Q1 of 2023, day ahead power prices out-turned around £240/MWh below the index price in the Default Tariff Cap allowance. At these price differentials, for every

10% error in hedged volume on an electricity and gas portfolio of Utilita's size there would be around £35m losses in a quarter (January to March) period. Capital is needed to protect customers from bearing the volume risk that they would otherwise bear because of the regulatory framework on the mutualization of losses.

- (b) *The disproportionality of the Capital Target and the Associated Compliance Framework.* EDFE submitted in its consultation responses that, for established players, the Capital Target should be no more than £100 (with powers for Ofgem to increase this where financial reporting data raises material concerns around individual supplier's financial resilience) but recognised that the £130 figure that was consulted upon was reasonable, provided it was kept under review. Oxera Consulting LLP's report dated 6 May 2022, that contained the findings from their independent review into Ofgem's regulation of the energy supply market (the "**Oxera Report**"), stated that a Capital Target is one option amongst many – and one requiring less intervention by Ofgem. EDFE considers this appropriate. Ofgem is not in the business of picking winners amongst business models. It has an obligation of non-discrimination. It is also the case that, at any point, a competitor such as Utilita can vary its strategy and target different customers and, in periods of tough market conditions in the absence of an appropriate minimum capital requirement, a competitor would be fully incentivised to do so. Business models are not static and can vary due to changes in market & economic conditions, or due to changes in ownership and business strategy. There is also an inherent risk, as noted above. Given the costs associated with a supplier exit and the risks that all market participants face, a Capital Target that is materially above zero is not one that can be objected to and there is no clearly better option. Indeed, the fact that Utilita does not recognise this risk in its NoA would appear to indicate it is not alive to such risk – which provides all the more reason to regulate.

- 1.8 *Calculation errors.* As noted, EDFE does not (currently) have visibility of the methodology under the Capital Target nor the Appellant's expert witness critique. EDFE did make submissions to Ofgem with respect to the Target and took the view that the figure consulted upon (£130) was reasonable – Ofgem subsequently revised the figure downwards to £115. EDFE would request that it be permitted to make

submissions on the calculations as and when it has visibility but without delaying the timetable for the appeal.

- 1.9 Points raised by Utilita but not addressed by EDFE should not be taken as acceptance – EDFE's intervention is focused on contributing evidence over and above the arguments or evidence. EDFE disputes, for example the references to "dominance".
- 1.10 EDFE does not rely on any witness statement but contemporaneous documentation. In general, EDFE has a number of individuals that contribute to its corporate view on policy interventions.
- 1.11 With respect to the relief sought, EDFE notes that the only relief sought is the quashing of the Capital Target for all market participants. An appellant is required to provide a statement of the relief sought and any directions necessary to give effect to that relief (CMA Rules 5.2(vi)).

2. The CMA Rules

- 2.1 The Energy Licence Modification Appeals: Competition and Markets Authority Rules 27 October 2022 CMA70 ("**CMA Rules**") set out the rules on an intervention application. These state:

"10.1 Where the CMA has granted permission to appeal, it may on the application of any person give permission to intervene.

10.2 In considering whether to grant permission to intervene, the CMA shall take account of all the circumstances including:

- (a) whether the applicant is materially interested in the outcome of the appeal;
- (b) whether the applicant's intervention in the appeal will assist the CMA to determine the appeal; and
- (c) whether granting permission to intervene would be proportionate in the circumstances."

- 2.2 Under Rule 10.5 the notice of intervention must:

"(a) include the applicant's main submission covering: (i) details of the appeal in which the applicant seeks to intervene; (ii) why the CMA should grant permission to intervene

with reference to the factors set out in Rule 10.2 above; (iii) any representations the applicant wishes to make concerning whether permission to intervene should be granted subject to any conditions; (iv) the applicant's substantive arguments on the appeal, comprising a statement of whether the applicant supports or opposes the appeal and the facts and reasons on which they rely, including an explanation of the relevance of any evidence or documents appended to the main submission; (v) particulars of any matter, information or evidence to which the CMA should have regard in determining the application or appeal; (vi) the applicant's name and address, and where applicable, the name and address of the applicant's legal representatives; (vii) an email address, together with a physical address in the UK, for the purpose of receiving documents;

(b) append a bundle of supporting documentation including: (i) any evidence on which the applicant wishes to rely in the form of witness statements or expert reports; (ii) any documents (or extracts of documents) to which the applicant believes the CMA should have regard in determining the appeal."

2.3 The requirements set out in CMA Rule 10.5(a) (i), (ii), (vi) and (vii) are set out above. The bundle of supporting documentation falling with (b)(ii) is provided herewith.

2.4 Set out below are the applicant's:

(a) Main reasons why the CMA should grant permission to intervene pursuant to CMA Rule 10.5(a)(iii); and

(b) substantive arguments on the appeal and particulars of any matter, information or evidence to which the CMA should have regard in determining the application or appeal are set out below pursuant to CMA Rule 10.5(a) (v) and (vi).

3. EDFE'S STANDING TO BE AN INTERVENER

EDFE is materially interested in the outcome of the appeal

3.1 EDFE holds an electricity supply licence under section 6(1) Electricity Act 1989, and a gas supply licence under section 7A Gas Act 1986, which entitle it to supply electricity and gas to its wide customer base.

3.2 For a long time, EDFE has been present in the UK market and has identified the risks for market participants. In the CMA's summary of the hearing with EDFE in the context of the CMA's Energy Market investigation, it is stated that:

"[EDFE] had been able to handle these spikes without passing on large price hikes to its customers because of its cautious hedging strategy. It considered that some of the current crop of new entrants who had riskier hedging strategies might not survive events like those of 2008..."

*EDF Energy expected that the independent suppliers' market share would continue to grow but that some current independent suppliers might leave [the market] if it turned out their business models were unsustainable. "*¹

3.3 There has been substantial market exit in recent years, with the costs being passed on to suppliers such as EDFE and its customers. EDFE wishes to minimise the risk of this in the future. EDFE has long been supportive of Ofgem's efforts in improving supplier financial resilience by introducing new measures that promote higher financial and risk management standards in the energy market, which minimise the risks and costs of supplier failures.

3.4 The energy crisis and market volatility between 2021-2022 exposed both the poor business practices *and* the undercapitalised nature of a number of former suppliers. Many smaller suppliers were poorly capitalised and used payments from customers as their working capital. Many of these suppliers accordingly focused on winning new customers over profitability as the payments enabled them to remain solvent. The drive for new customers led to pricing below marginal cost which required them to effectively be unhedged. Their subsequent failure when prices spiked further undermined the financial stability of hedged suppliers by flooding them with unhedged customers and leading to significant losses for those that remained. These costs are ultimately borne by consumers and are not recoverable over the short term. This was identified in the Oxera Report.² Commenting on the lack of the resilience in the energy

¹ See CMA, Energy Market Investigation, Summary of hearing with EDF Energy on 11 March 2015 (https://assets.publishing.service.gov.uk/media/55843bed40f0b615b300000f/EDF_hearing_summary.pdf), paras 32 and 39.

² Oxera Consulting LLP, Review of Ofgem's regulation of the energy supply market, 3 May 2022 (https://www.ofgem.gov.uk/sites/default/files/2022-05/Review%20of%20Ofgems%20regulation%20of%20the%20energy%20supply%20market_May%202022.pdf).

market prior to the energy crisis due to new entrants capitalising on low-spot energy prices, the Oxera Report stated that:

"low levels of financial resilience have been caused by some suppliers' pursuit of riskier business models—both enabled and incentivised through capital inadequacy and the use of customer balances."

3.5 The BEIS Select Committee in July 2022, also had the following to say:

*"..suppliers [were allowed] to enter the market without ensuring they had access to sufficient capital, acceptable business plans, and were run by individuals with relevant expertise. The regulator enabled poorly capitalised suppliers to be overly reliant on customer credit balances and operate with inadequate hedging, leaving the market ill-equipped to absorb wholesale price increases. The rules that were in place were not enforced and Ofgem did not understand the business models of the suppliers it is mandated to supervise."*³

3.6 While Ofgem may have learnt many lessons, one risk that it is right to avoid is having to pick winners from business models. All suppliers were exposed to the risks arising from the energy crisis and could all be exposed again. The capital requirements will mean suppliers must adopt more sustainable business strategies, where profits are generated to fund them. The absence of a minimum capital requirement could have the reverse effect of incentivising certain suppliers to adopt less sustainable business strategies, particularly at points of distress.

3.7 There is in any event the volume risk referred to above. This relates to a market participant needing to be well capitalised in order to withstand the sometimes difficult headwinds that exist in the energy supply business cycles. There are, almost inevitably, going to be "shocks" – whether due to weather, geopolitical events or otherwise. Having sufficient capital to withstand such headwinds is necessary to avoid suppliers being able to take advantage of an asymmetric risk – that they can benefit from the "good times" and exit without capital risk in more difficult times.

3.8 The Oxera Report identifies this explicitly:

³ House of Commons Business, Energy and Industrial Strategy Committee, Energy pricing and the future of the energy market, Third Report of Session 2022-23, 26 July 2022 (<https://committees.parliament.uk/publications/23255/documents/169712/default/>), p. 3.

“we have gathered evidence from stakeholders of two business models that have been sustained by various features of Ofgem’s regulation of the market, which particularly exposed suppliers to supply or demand shocks and contributed to market instability. These are: a timing model where suppliers enter at favourable moments in the wholesale market; and a growth model where suppliers rely on customer prepayments to fund their growth. In both cases, it seems plausible from our assessment that these models were followed by some suppliers, with reference to the incentives faced by suppliers in the market from the regulatory regime. While it is not possible to conclusively determine the extent to which these business models were used by some suppliers in the financial and market data, the empirical evidence does support aspects of both hypotheses.”⁴ (emphasis added)

- 3.9 The reduction in supplier failure reduces the mutualised costs that are recovered from all energy customers. Consumers will also benefit from suppliers with sufficient funds to invest in the transition to net zero and continued innovation. This will bring long-term benefits in both the reduction of carbon emissions and costs for consumers.

The Intervention will assist the CMA to determine the Appeal

- 3.10 EDFE will assist the CMA by providing evidence and arguments that are not currently represented in the Appeal. This will ensure the CMA has the perspective of a long-standing participant involvement in the industry with the accrued knowledge, experience and evidence from other stakeholders as to the risks and exposures that are common across suppliers, regardless of business model.

- 3.11 EDFE is a party that has actively engaged in the regulatory process, critiquing Ofgem's proposals before, ultimately, agreeing that what Ofgem proposed was appropriate. On 3 January 2023, EDFE wrote to Ofgem stating:

“... the current proposal for setting minimum capital requirements on all domestic suppliers will entail considerable costs for consumers and suppliers with minimal benefits in many cases. It is also surprising that this has not been subject to a more detailed policy consultation before being advanced to a Statutory Consultation. This will have prevented suppliers and other interested stakeholders from having the

⁴ Oxera Report, p. 5.

*opportunity to consider more broadly the most proportionate approach to meeting Ofgem's objectives."*⁵

3.12 EDFE also submitted that the proposal for Pillar 1 of the minimum capital amount was too high when compared to what the account was worth. Despite this, EDFE noted:

*"Nonetheless, we agree that suppliers cannot be allowed to operate by Ofgem with minimal capital, as has often been the case in the past, to ensure that investors share any risk of liquidation with consumers and the wider industry. The current arrangements have led to significant risk of 'moral hazard' where any profits are owed to the directors/investors, but with any losses ultimately paid for by consumers through the mutualisation processes. There is, however, disparity between making investors share such risks to incentivise responsible behaviour and deciding that a high level of equity (net assets) is a good measure of financial resilience for the future. Ofgem should recognise that these are two separate issues that both require addressing in a robust manner individually. Ofgem's current Pillar 1 minimum net assets measure requirement is insufficient to cover either issue, let alone both."*⁶

The Intervention is proportionate in the circumstances

3.13 EDFE proposes to only intervene on the necessity of the Capital Target, in relation to: (i) the risk to businesses in the market generally, including the severely tested resilience of Utilita and others; (ii) the impact on other participants; and (iii) the proportionality of the regulatory requirement. It is not, at this stage, in a position to comment on any detailed critique or calculations made as to the precise level of the Capital Target. To the extent, when relevant material is disclosed, EDFE has observations on the arguments made, EDFE would propose to apply to make such observations at that time.

3.14 Thus, having taken into account the range and nature of the issues and the submissions received by the CMA, EDFE identified aspects in which it could assist the CMA. EDFE's intervention will be limited to the matters on which it can supplement the evidence and arguments that would otherwise be before the CMA.

⁵ Annex 1 – EDFE 3 January 2023 submission on Ofgem's 25 November 2022 Consultation.

⁶ *Ibid*

3.15 EDFE may be able to assist at the scheduled hearing. EDFE would look to make available relevant business people that contributed to the preparation of EDFE's consultation responses. EDFE would look to limit oral submissions made.

4. **BACKGROUND TO THE DECISION**

4.1 EDFE have long made the case for increased regulatory oversight and monitoring of financial resilience and viability in the energy market due to the impact on suppliers and consumers from increased mutualisation costs from repeat supplier failure. EDFE brought this to Ofgem's attention as early as January 2019 and consistently argued for new measures – with the issue becoming more acute in 2022:

- (a) In response to Ofgem's Supplier Licensing Review published on 21 November 2018, EDFE submitted in January 2019 that "*A string of supplier failures, together with a number of defaulting suppliers has, for the first time, resulted in shortfall levels for the Renewables Obligation (RO) and Feed in Tariff (FiT) schemes being sufficient to trigger mutualisation.*"⁷
- (b) In response to the Ofgem's consultation on new applications regulations and application guidance document published on 11 April 2019, EDFE submitted in May 2019 that "*While checks undertaken on market entry will have some benefits, we believe that Ofgem should have a greater, more effective, role in monitoring the financial resilience of all suppliers on an ongoing basis. We therefore look forward to Ofgem progressing to the next stage of its review and we are keen to work with Ofgem to develop an approach which is effective, targeted and proportionate with the aim of reducing the risks to consumers and suppliers.*" (emphasis added)⁸
- (c) In response to Ofgem's consultation on developing a framework for assessing whether conditions are in place for effective competition in domestic supply contracts published on 29 May 2019, EDFE submitted in July 2019 that:

"Healthy competition exists where there is an established level playing field. Therefore, distorting policy exemptions must be removed and robust financial

⁷ Annex 2 – EDFE 23 January 2019 response to Ofgem's Supplier Licensing Review of 21 November 2018.

⁸ Annex 3 – EDFE 13 May 2019 submission in response to Ofgem's consultation on new applications regulations and application guidance document published on 11 April 2019.

*standards put in place to ensure that all suppliers bear an appropriate share of the risk that they impose on the wider energy system e.g. via mutualisation. **This should also be supported by ongoing comprehensive monitoring of the financial resilience of all suppliers to give visibility of the sustainability of suppliers' business models and protect the long-term interests of consumers ...** Recent supplier exits from the market have in some instances occurred primarily due to the adoption of low pricing strategies that have left parties unable to meet their obligations and resulted in their failure, cost mutualisation and customer detriment."* (emphasis added)⁹

- (d) In response to the Department for Business, Energy & Industrial Strategy & Ofgem's consultation on a Flexible and Responsive Energy Retail Market published on 22 July 2019, EDFE submitted in September 2019 that:

*"When a supplier fails and exits the market this can be disruptive to their current (and previous) customers, lead to additional mutualised costs and undermine trust in the sector. **There is a clear need for more effective ongoing regulatory monitoring of the financial resilience of all suppliers in order to minimise the costs and detriment that result from such failures.**"* (emphasis added)¹⁰

- (e) In response to Ofgem's consultation on Supplier Licensing Review: Ongoing requirements and exit arrangements published on 22 October 2019, EDFE submitted in December 2019 that:

*"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.**"*

⁹ Annex 4 – EDFE 9 July 2019 submission in response to Ofgem's consultation on developing a framework for assessing whether conditions are in place for effective competition in domestic supply contracts published on 29 May 2019.

¹⁰ Annex 5 - EDFE 16 September 2019 submission in response to the Department for Business, Energy & Industrial Strategy & Ofgem's consultation on a Flexible and Responsive Energy Retail Market published on 22 July 2019.

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." (emphasis added)¹¹

- (f) In response to Ofgem's consultation on the Forward Work Programme for 2020-2022 published on 20 December 2019, EDFE submitted in February 2020 that it:

*"has fully supported Ofgem's review of the supplier licensing regime with a view to introducing targeted and proportionate changes that ensure consumers are better protected and risks are minimised for existing suppliers. Specifically, we are supportive of Ofgem considering options that would introduce improved cost mutualisation protections."*¹²

- (g) In response to Ofgem's consultation on Reviewing the Consolidated Segmental Statement – Our Initial Proposals published on 21 May 2020, EDFE submitted in August 2020 that:

"In order to protect customers it is important that the regulator has visibility of the financial status of all kinds of market participants, both individually and collectively, including to assess the impact of its own policy implementation on suppliers and the market in general. However, the information available to Ofgem through the CSS will need to be supplemented by additional more frequent monitoring including that proposed through the supplier licensing review, particularly in circumstances where significant concerns arise regarding the financial solvency of individual parties." (emphasis added)¹³

¹¹ Annex 6 – EDFE 3 December 2019 submission in response to Ofgem's consultation on Supplier Licensing Review: Ongoing requirements and exit arrangements published on 22 October 2019.

¹² Annex 7 – EDFE 21 February 2020 submission on Ofgem's consultation on the Forward Work Programme for 2020-2022 published on 20 December 2019.

¹³ Annex 8 – EDFE 12 August 2020 submission on Ofgem's consultation on Reviewing the Consolidated Segmental Statement – Our Initial Proposals published on 21 May 2020.

- (h) In response to Ofgem's Statutory Consultation on Supplier Licensing Review: Ongoing requirements and exit arrangements published on 25 June 2020, EDFE submitted in August 2020 that:

*"We are therefore fully supportive of Ofgem looking to introduce licensing changes that aim to improve its ongoing financial oversight of suppliers and promote higher financial and risk management standards in the energy market in order to minimise the costs and detriment that result from such failures for both customers and suppliers."*¹⁴

The Energy Crisis exposed volume risk

- 4.2 EDFE's concern about market practices pre-dated the energy crisis of 2021 to 2022, the impacts of which remain ongoing. However, the energy crisis highlighted that the relevant risks could become far more acute than even EDFE had previously anticipated. Volatile and high energy prices led to the collapse of over 30 suppliers, at a cost to consumers that current estimates place in excess of £2.7 billion¹⁵. In its inquiry into 'energy pricing and the future of the energy market' in July 2022, the BEIS Select Committee found that Ofgem had created a market environment that was not sustainable by allowing:

*"suppliers to enter the market without ensuring they had access to sufficient capital, acceptable business plans, and were run by individuals with relevant expertise."*¹⁶

- 4.3 The energy crisis highlighted the large volume risks that suppliers were exposed to through the operation of the energy cap. The Default Tariff Cap operates on the basis of suppliers hedging in advance according to an index as set out by Ofgem, so that energy costs match those assumed within the price cap formula. However, to buy the correct volume of energy, suppliers must forecast the correct number of customers and how much energy they will consume. In the energy crisis, the price cap level was overshadowed by a price spike between the hedging period and the commencement of

¹⁴ Annex 9 – EDFE 20 August 2020 submission on Ofgem's Statutory Consultation on Supplier Licensing Review: Ongoing requirements and exit arrangements published on 25 June 2020.

¹⁵ House of Commons Business, Energy and Industrial Strategy Committee, Energy pricing and the future of the energy market, Third Report of Session 2022-23, 26 July 2022 (<https://committees.parliament.uk/publications/23255/documents/169712/default/>), p. 3.

¹⁶ House of Commons Business, Energy and Industrial Strategy Committee, Energy pricing and the future of the energy market, Third Report of Session 2022-23, 26 July 2022 (<https://committees.parliament.uk/publications/23255/documents/169712/default/>), p. 3.

the tariff period, and many customers moved to the Default Tariff Cap unexpectedly, leaving suppliers with the need to buy - now much higher cost energy - to supply them. Utilita's NoA does not address or highlight this risk. Although Utilita survived, it remains exposed to this risk and therefore should maintain a minimum capital commitment.¹⁷

The June 2022 Consultation

- 4.4 Ofgem published its consultation on "Strengthening Retail Financial Resilience" on 20 June 2022 (the "**June 2022 Consultation**").¹⁸ The consultation was deemed necessary to build an energy market where retail suppliers are financially resilient, and where risks are not inappropriately passed to consumers. The June 2022 Consultation involved policy considerations for protecting customer credit balances and money collected to meet Renewables Obligation ("**RO**") payments. In addition, the June 2022 Consultation proposed the introduction of specific capital adequacy requirements for suppliers and the development of a minimum capital buffer based on the capital a well-hedged supplier needed to ensure they could withstand a certain shock and remain solvent. Ofgem hoped that the proposed policy options would ensure that consumers, energy suppliers and investors could have confidence in the energy supply market going forward.
- 4.5 EDFE provided a response to the June 2022 Consultation by way of a letter from Jon Cole, Senior Manager, Customers Policy and Regulation at EDFE dated 19 July 2022 (the "**July 2022 Response**").¹⁹ The July 2022 Response was broadly supportive of the proposed measures and expressed its continued support for Ofgem's attempts to improve the financial resilience of the retail market on the basis that it would lead to more sustainable competition in the long-term, to the benefit of consumers. EDFE stated that it was keen to work with Ofgem to engender a capital adequacy regulatory approach that is targeted and proportionate to the risks imposed by individual suppliers.
- 4.6 In the July 2022 Response, EDFE agreed that the capital adequacy regime should be risk-based and should, in particular, target whole cost exposure (especially for fixed

¹⁷ EDFE notes that Ofgem has made regulatory changes, such as calculating the cap every 3 months, in response to the acute risk. Whilst this might reduce the risk, it does not eliminate it.

¹⁸ Ofgem, Policy Consultation – Strengthening Retail Financial Resilience, 20 June 2022 (https://www.ofgem.gov.uk/sites/default/files/2022-06/FRC_PC__1906_FINAL_PUBLISHED.pdf).

¹⁹ Annex 10 – EDFE 19 July 2022 response to the Ofgem's 20 June 2022 Consultation.

term contracts) and ensure supplier obligation risks, such as smart metering installations and RO payments, were accounted for. Whilst EDFE thought that the level of financial resilience required would depend on the risks that the capital adequacy regime is targeting, the July 2022 Response supported Ofgem's definitions of going-concern and contingent capital as the appropriate capital to include under capital adequacy requirements.

The November 2022 Consultation

- 4.7 Following responses to the June 2022 Consultation, Ofgem published a consultation containing its revised proposals in relation to minimum capital requirements for domestic suppliers (the "**November 2022 Consultation**").²⁰ The November 2022 Consultation proposed setting a shorter-term target for domestic suppliers to have £110-220 per domestic customer of net assets by end of March 2025, with suppliers required to submit transition plans showing clear 'staging posts' or increments for how they intended to reach that target. The November 2022 Consultation made it clear that the target was based on a notional supplier that is a theoretical and efficient supplier that has no direct comparison with existing suppliers but draws from the properties across efficient suppliers in the market. In this way, the Capital Target would target risks common to all suppliers given that, at a base level, the energy crisis exposed issues that effected suppliers in similar ways leaving only the most resilient companies surviving.
- 4.8 EDFE submitted a response to the November 2022 Consultation by way of a letter from John Mason, Senior Manager (Price Regulation & Market Dynamics) at EDFE dated 3 January 2023 (the "**January 2023 Response**").²¹ Whilst the January 2023 Response supported the general direction of travel in the November 2022 Consultation, EDFE did not, at that time, consider that the proposal for the minimum capital requirements was the correct way to approach a capital adequacy arrangement. EDFE did recognise that there had to be some form of minimum capital as suppliers could not be allowed to operate by Ofgem as had been the case in the past - Ofgem needed ensure that investors share any risk of liquidation with consumers and the wider industry. EDFE therefore

²⁰ Ofgem, Statutory Consultation – Strengthening Financial Resilience (<https://www.ofgem.gov.uk/publications/statutory-consultation-strengthening-financial-resilience>), 25 November 2022.

²¹ Annex 1 – EDFE 3 January 2023 submission on Ofgem's 25 November 2022 Consultation.

suggested an alternative approach that it argued better achieved Ofgem's stated aims that was based around the share capital of suppliers. This consisted of:

- (a) A new "minimum financial resources" requirement for all suppliers to demonstrate that suppliers are a going concern;
- (b) A Minimum Capital Adequacy arrangement for all suppliers, based on share capital (and not net assets) or alternate financial approaches. For established and stable suppliers, EDFE thought that this should be no more than £100 per domestic customer; and
- (c) Powers for Ofgem, as it had for Customer Credit Balances, to be able to increase this level of Minimum Capital Adequacy where financial reporting data (e.g. rapid growth) raises material concerns around individual supplier's financial resilience.

4.9 EDFE identified several weaknesses with the approach outlined by Ofgem, focusing on the lack of a link between a "minimum capital requirement" to ensure financial resilience and a net assets measure. EDFE outlined a non-exhaustive list of examples for that reasoning (although this is not an exhaustive list):

- (a) A Fair Value derivative asset related to a hedge book of purchase commodity trades gives a false impression of financial resilience, as it implies that a supplier could meet liabilities by unwinding its hedge position – which would in fact reduce its financial resilience.
- (b) Many fixed assets (investments in subsidiaries, IT systems, capitalised acquisition costs) are not liquid and cannot be monetised quickly (or even at all) to meet liabilities that require payment.
- (c) Fixed assets are normally recorded using historical cost, which therefore may misrepresent their fair value.
- (d) Some long-term borrowings may not fall due for a significant period, and therefore may not impact financial resilience at all within the assessment period.
- (e) A net asset approach would allow Director loans to be counted as assets that can be used to fund the liquidity of the entity, when these may be of low likelihood of repayment.

- (f) A net asset test could lead to an incentive to adopt accounting policies which may lead to inappropriate capitalisation of assets or accelerated revenue recognition.
- (g) A net asset test does not consider available credit facilities or intragroup funding or support.

4.10 EDFE's position was that Ofgem's proposed range for the minimum capital requirement was too high to be appropriate for all suppliers. For instance, £110-£220 was considerably more than the £75/account price paid per account by OVO for the SSE customer base. EDFE submitted that minimum capital requirements at that level would reduce future investment in the retail industry, particularly when combined with the fact that Ofgem were considering in reducing the EBIT allowance, whereby Ofgem set the allowance within the Price Cap for the rate of return for suppliers serving standard variable tariff (SVT) customers.

4.11 EDFE did, however, recognise there should be circumstances where the minimum capital requirement was higher than £100 under its alternative proposal:

- (a) New entrants to the markets should have having higher capital adequacy requirements (in excess of £100 per customer), until such time as they have proven their financial robustness and stability.
- (b) A supplier that experiences rapid growth should act as a trigger point for Ofgem to consider whether further action is needed with regards to increasing a supplier's capital adequacy requirements exponentially in line with growth.

The April 2023 Decision

4.12 Ofgem published a decision on 5 April 2023 entitled "*Decision in Strengthening Financial Resilience*" (the "**5 April Decision**").²² The 5 April Decision introduced the requirement for suppliers to ringfence their Renewable Obligation (RO) attributable to domestic supply and to enhance the existing Financial Responsibility Principle set out in supplier licences. The 5 April Decision did not impose a minimum capital

²² Ofgem, Decision on Strengthening Financial Resilience, 5 April 2023 (<https://www.ofgem.gov.uk/sites/default/files/2023-04/Decision%20on%20Strengthening%20Financial%20Resilience.pdf>).

requirement or direct ringfencing of customer credit balances as Ofgem indicated that it would consult further on the issue.

The 5 April Consultation

- 4.13 Ofgem published a further consultation entitled "*Further Statutory Consultation: Strengthening Financial Resilience– introducing a Minimum Capital Requirement and Ringfencing CCBs by Direction*" on 5 April 2023.²³
- 4.14 Ofgem revised its proposal in relation to the minimum capital requirement, and now suggested that suppliers maintain a Capital Floor of £0 Adjusted Net Assets per customer from 31 March 2025 and meet a Capital Target equivalent to £130 Adjusted Net Assets per dual fuel customer from 31 March 2025. Any suppliers that did not meeting the Capital Floor would be in breach of the licence condition, whereas any suppliers not meeting the Capital Target would be required to submit a Capitalisation Plan showing how they intended to reach the capital target. A non-compliant supplier would then be subject to transition controls until they had an acceptable plan in place. The 5 April Decision sought views on the compliance framework, the level of the Capital Floor and Capital Target and the definition of Capital.
- 4.15 EDFE responded to the 5 April Consultation by way of a letter from John Mason dated 3 May 2023 (the "**3 May Response**").²⁴ Whilst the 3 May Response maintained the position that a share capital approach in relation to a minimum capital requirement would be more effective, EDFE accepted that prior concerns with a net asset measure could be addressed through an adjusted net assets approach that only included those assets that can be used to limit mutualisation costs in the event of a supplier failure. The rationale for this was straightforward – only those net assets that were liquid and could be realised should be included for the purpose of the requirement. The inclusion of assets such as highly illiquid fixed assets do not contribute to a supplier's ability to withstand shocks and volatility within the energy market. The adjusted net assets approach is a reasonable compromise in response to supplier feedback: simple to understand, based on publicly available information and easy to measure.

²³ Ofgem, Further Statutory Consultation: Strengthening Financial Resilience- introducing a Minimum Capital Requirement and Ringfencing CCBs by Direction, 5 April 2023 (<https://www.ofgem.gov.uk/sites/default/files/2023-04/Strengthening%20Financial%20Resilience%20-%20April%20Statutory%20Consultation.pdf>).

²⁴ Annex 11 - EDFE 3 May 2023 submission on the 5 April Consultation.

- 4.16 EDFE considered that there was an argument that the Capital Floor should be higher, but accepted both the level of the Floor and Target as conservative introductory levels that could be revised to ensure Ofgem's policy aims were being met.

The Decision

- 4.17 Ofgem published its decision in relation on introducing a minimum capital requirement and ringfencing customer credit balances by direction on 26 July 2023 (the "**Decision**").²⁵ The Decision confirmed that Ofgem had decided to proceed with the introduction of a minimum capital requirement Floor and Target supported by the Capitalisation Plan framework, effective from 31 March 2025. In response to EDFE's concerns, Ofgem removed intangible assets from the definition of capital. It also lowered the Target to £115 per domestic dual fuel equivalent customer.

5. THE CAPITAL TARGET IS NECESSARY

- 5.1 EDFE welcomed the Decision as an appropriate and effective measure to lessen the risk of supplier failure. It established a common minimum that combatted the risks faced all types of suppliers regardless of business model or size. EDFE's position is that the Decision should stand and that the appeal should not succeed.

The Capital Target will limit Supplier Failure and Reduce Mutualisation Cost

- 5.2 As noted above, the energy crisis highlighted the very large volume risks that suppliers were exposed to through the operation of the Price Cap.
- 5.3 This risk applies regardless of the business model pursued by businesses, and whether or not a supplier is well hedged, offered SVT only and / or a prepayment meter-lead supplier, as with Utilita. Ultimately, only by having a Capital Target will Ofgem be able to move towards a market where there is not an asymmetric risk for market participants.
- 5.4 For instance, Bulb achieved the position as a large supplier pursuing an SVT only business-model on the basis that variable tariffs could deliver better value to consumers than fixed price tariffs and that not all variable tariffs are expensive deemed tariffs. Bulb

²⁵ Ofgem, Decision on introducing a minimum capital requirements and ringfencing customer credit balances by direction, 20 September 2023 (<https://www.ofgem.gov.uk/publications/decision-introducing-minimum-capital-requirement-and-ringfencing-customer-credit-balances-direction>). Note that the Decision was updated on Ofgem's website to include the Erratum Notice for SLC 4B that was issued on the 20th September 2023.

still failed when it met with the exigencies of the energy crisis despite its apparent success. Bulb initially experienced significant growth, which then slowed down as it struggled to attract new customers. As highlighted by the Oxera Report²⁶, at the same time, its total equity declined slightly before leading to a sharp reduction from 2018 to 2019 when customer growth stagnated. With reduced equity, Bulb was unable to absorb the increased strain on its available capital from the rocketing energy prices, leading to one of the largest UK corporate bailouts since the 2009 financial crisis. A Capital Target would have gone some way to addressing the underlying reasons for Bulb's failure and would at least have reduced the mutualisation cost.

- 5.5 The failure of Economy Energy in 2019 offers another pertinent example. Economy Energy focused on and had approximately 70% of customers on prepayment meters. Frequent failure to meet RO payments and the eventual revocation of its licence added to mutualisation costs, ultimately impacting the consumer. According to the Financial Times, its failure was due to customer service.²⁷
- 5.6 Utilita itself has already faced significant losses in the past, with losses incurred of £27,874,000 in 2019 and £19,225,000 in 2020 according to its financial statements for the year ending 31 March 2020.²⁸
- 5.7 It is critical importance that the minimum capital requirement is structured in a way applies to all businesses without exception. Whilst the energy market should be able to accommodate various business models to ensure a thriving pro-competitive environment, the experience of the past does not guarantee survival in the future.
- 5.8 Indeed, EDFE, despite a number of factors including prudent hedging, a risk-adverse business model, significant experience in the sector, and a lack of reliance on credit balances, still experienced significant financial losses during the energy crisis as did every supplier. In those circumstances, the introduction of a minimal capital requirement is critical.

The Capital Target is an important addition to the regulatory framework

²⁶ Oxera Report, p. 52.

²⁷ Financial Times, Economy Energy ceases trading as supplier failures persist, 8 January 2019 (<https://www.ft.com/content/5ae84688-1345-11e9-a581-4ff78404524e>).

²⁸ Annex 12 - Utilita Energy Limited's Financial Statements for FY2020

5.9 Whilst Ofgem's other measures to enhance the financial resilience of energy suppliers are welcome, such as the requirement for suppliers to ringfence their RO attributable to domestic supply and to enhance the existing Financial Responsibility Principles, these measures alone will not eliminate both the ability of and incentive for suppliers to pursue riskier business models with lower levels of capital. The combination of ring-fencing RO payments and improved protection of customer balances, alongside a capital adequacy requirement provides the securest method by which Ofgem can reduce the incidence of supplier failure and the cost of such failure when it occurs.

The Capital Target will benefit the energy market at large

5.10 We do not accept that the Capital Target will systematically favour the "Big Six" legacy suppliers but will rather be in the interest of the market at large. There are many differences between the so-called "Big Six", a point EDFE made at length to the CMA in its various submissions in the *Energy Market Investigation*.

5.11 In any event, suppliers should not be allowed to operate with minimal capital. Absent investors having 'skin in the game' and hence sharing the risk of liquidation with consumers and the wider industry, there would be significant 'moral hazard' where any profits are owed to the directors/investors, but with any losses managed through mutualisation processes. Utilita has not explained this. Its argument that reporting suffices fails to address the reality – no regulator is perfect; the market is complex and there are many unanticipated shocks. As such, a Capital Target above zero is necessary to protect or mitigate the risk that ultimately customers must bear.

5.12 As emphasised to Ofgem, EDFE had concerns at the risk posed to the market by new entrants due to the lack of a track record of resilience. A Capital Target set at £115 per customer strikes a balance between ensuring entrants are robustly financed and have sufficient capital when entering the market against imposing too demanding a cost for market competitors.

5.13 It is also evident that Ofgem has settled on the appropriate definition of capital for the purposes of the Capital Target. In accordance with EDFE's submissions, it makes sense to exclude non-current assets that have no ability to absorb unexpected losses, whilst recognising alternative forms of capital, such as shareholder loans, that companies can

draw on. These forms of capital are the most reliable in enabling suppliers to see out market volatility.

6. PROPORTIONALITY OF THE CAPITAL TARGET AND ASSOCIATED COMPLIANCE FRAMEWORK

- 6.1 For the above reasons, it is clear that a Capital Target materially above zero and an associated compliance framework is proportionate to the industry wide. There is a clear connection between preventing supplier failure and the minimum capital requirements.
- 6.2 In the NoA, Utilita has requested that the Capital Target – for all suppliers – is quashed. This would reintroduce to the industry the moral hazard that BEIS and Oxera both identified. The absence of a Capital Target would mean that, during periods of stress (which are inevitable in the current global market conditions), suppliers might be incentivised, rather than deterred, from pursuing riskier business strategies, directly ignoring the lessons of the recent energy crisis. This would leave consumers completely exposed.
- 6.3 Ofgem have acted as any rational regulator would in view of the experience of the multivarious challenges in the market by bringing in a reasonable and proportionate measure to combat risks that are inherent to all suppliers. In the circumstances where

EDFE consider a minimum capital requirement is necessary, despite the strength of its business, it should also be necessary for any other supplier, including Utilita, who are likely to be exposed to even more risk.

EDF Energy Customers Limited

12 October 2023

Statement of Truth pursuant to Rule 10.6 of the CMA Rules

I believe that the facts stated in this submission are true. I understand that proceedings for contempt of court may be brought against anyone who makes, or causes to be made, a false statement in a document verified by a statement of truth without an honest belief in its truth.

Signed

Joe Souto

General Counsel, EDFE

12 October 2023