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Dear Sir / Madam

We are writing in response to your consultation on proposed changes to the Electricity Supplier Obligation Regulations in response to COVID-19. This response is non-confidential and may be published on your website.

We recognise these proposals are motivated by a desire to provide a short term financial buffer to a supply sector that is facing unexpected additional costs and potential disruption to cashflow as a result of the pandemic. By providing breathing space, it may reduce the risk of supplier failures in the short term. While the loan to the LCCC is being provided interest free, government borrowing rates are at historic lows and the government is assured of getting its money back given the way in which any CfD debts that are defaulted on are socialised among other suppliers. In the round, this may appear to make it a low risk way for the government to provide financial assistance to the sector.

Although the risk of bad debt to citizens as taxpayers is low, the same is not true of the risk to them as bill-payers, given the way in which unpaid sector debts are socialised across other market participants when suppliers fail. It is possible this deferral may reduce consumers' exposure, by allowing some suppliers to survive who would otherwise fail. But equally, it may increase it, by simply delaying their failure to a later point at which they have accrued more debts. The risk of the latter is material, and it will be important that both Ofgem and the department keep strict oversight of the sector's debt situation, and intervene, if necessary, to stop consumer exposure from escalating.

There are several issues that may impact on the effectiveness of these proposals that are not really touched upon in the consultation.

The main one of these is the uncertainty on the shape and timing of economic recovery and how it may impact on suppliers ability to pay in future. The monies covered by this loan that were due to be paid by suppliers in Q2 2020 will be deferred until Q1 2021 - but there is no guarantee that suppliers will be any more able to repay them then than they are now. That risk is significant: many suppliers were already unprofitable going into the crisis; indeed, anecdotal evidence suggests that one reason why many have been refused loans under the government's new

schemes is that they fail bank lending criteria (i.e. they are deemed unsustainable and likely to default). Because of this, there is a risk that these proposals do not prevent defaults, but simply ‘kick the can down the road’ from this summer to next spring.

There may be value in the deferral despite those risks. For example, it is likely that the process of managing the market exit process, whether through the Supplier of Last Resort (‘SoLR’) process or through trade sales, will be more straightforward once normal working conditions have been established, post-pandemic. This could result in better consumer outcomes - smoother transfers, with more support available to affected consumers. We expect deferrals of this nature to enable suppliers to maximise the additional support they are able to provide to customers under the voluntary agreement with BEIS, and to keep this in place for longer.[1] These outcomes are uncertain, however.

We note that although the proposal is that this deferral is a one-off, that the changes to the regulations would allow for it to be repeated. Given the above, we think the government should be acutely aware of the risk of creating a precedent that it cannot easily escape - that in the same way a deferral may appear attractive now to prevent defaults, that it may appear attractive again in 9 months time, and so on. There is therefore some risk that the government may become stuck providing a rolling credit facility to bailout unsustainable suppliers. To mitigate against this risk, you may wish to consider removing that ability to repeat deferrals from the regulations, though we recognise that this would come at the cost of reducing your flexibility to respond to future market conditions.

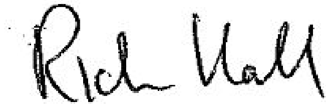
It is not clear from your proposals why you have settled on 9 months as the optimal deferral length, and more detail on this would be useful.

The basis of your assessment of how much financial assistance suppliers require (eg why you are choosing to cover 67% of the projected uplift rather than a higher or lower figure) is also unclear, and we would like to see it more fully articulated when you publish your final decision on these proposals. We note that suppliers’ exposure to higher CfD costs is likely to vary significantly, and will be influenced by how they have hedged their position in wholesale markets. Because CfD top up payments are calculated using a market based reference price, exposure to the two costs is somewhat inversely related (i.e. as wholesale prices go down, CfD liabilities go up, and vice versa). This relationship is imprecise, as most suppliers will have hedged

[1] An agreement is in place between government and industry to provide enhanced support during the pandemic, however it is voluntary and does not bind supplier behaviour. ‘Government agrees measures with energy industry to support vulnerable people through COVID-19.’ BEIS, 19 March 2020.

their wholesale purchases over a period of time and are likely to have a higher weighted average purchase price than the current extremely low wholesale prices. However, we are aware that some suppliers appear to be wholly, or largely, unhedged which may be largely netting out the impact of higher CfD liabilities.

Yours sincerely



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