Energy UK

The voice of the energy industry

Consultation on proposed changes to the CfD Electricity Supplier Obligation Regulations in response to COVID-19

19 May 2020

Introduction

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering almost all (90%) of both the UK's power generation and energy supply for over 27 million UK homes as well as businesses. The energy industry invests over £13.1bn annually, delivers around £85.6bn in economic activity through its supply chain and interaction with other sectors, and supports over 764,000 jobs in every corner of the country.

This is a high-level response to BEIS' consultation on proposed changes to the Contracts for Difference (Electricity Supplier Obligation) Regulations 2014 ("the ESO Regulations") in response to COVID-19. We would be happy to discuss any of the points made in further detail with BEIS or any other interested party if this is considered to be beneficial.

Executive Summary

Energy UK welcomes the support BEIS is providing to the LCCC to minimise the immediate shock of additional Contracts for Difference (CfD) costs resulting from COVID-19 and we generally agree with the proposals set out in the consultation.

A majority of Energy UK's members are concerned that the proposed timing of repayment via increased supplier obligations in Q1 2021 would not be the optimal approach, and risks unintended consequences to suppliers' finances as they exit the winter period. It could be better for customers if recovery of the additional costs was moved to Q2 2021, which would also minimise the impact of seasonality distortions on market share by eligible demand.

However, concerns have also been shared that extending the repayment timeline in such a way would increase the risk of failed suppliers' costs being mutualised, and non-domestic suppliers' ability to recover costs from their customers if a greater number have ceased operating as a result of the anticipated recession. Given the wider implications for both the domestic and non-domestic market, and customers, we would urge BEIS's decision making to take full account of the impacts of its repayment timeline.

Energy UK would also welcome clarity as to how BEIS has arrived at the decision to only cover 67% of additional CfD costs, as it has not set out in detail its workings. While we recognise its rationale that the fall in wholesale prices cannot be fully ascribed to COVID-19 related factors, BEIS should set out how it arrived at the proposed percentage of support. Initial analysis suggests that a more appropriate proportion of additional costs attributable to COVID-19 would be in the 80-90% range. As such, BEIS should transparently review its workings to ensure that the support provided is robust and sufficient for the impact of COVID-19.

Energy UK would also welcome BEIS' considerations for a support mechanism to cover the sharp (£400m+) increases in Balancing Services Use of System (BSUoS) charges expected by National Grid ESO between May and August 2020 as a result of COVID-19.

1. Do you agree with the proposed method for calculating the reduction in suppliers' obligations by the amount of the government loan provided to the LCCC to make CfD payments?

Energy UK agrees that the methodology used to reduce suppliers' obligations is reasonable.

However, it is unclear from the consultation document how BEIS has arrived at the decision to only fund 67% of the additional CfD costs (up to the cap of £100m) via its loan to the LCCC. We recognise BEIS' rationale that not all of the wholesale price reduction can be directly attributed to COVID-19. However, we would welcome reconsideration of this figure, and clarity as to how it was derived.

As an example, the data from the LCCC (as revised on 12 May) shows that the Q2 shortfall is a result of 5.6% higher payments and 14.1% lower demand. It would be reasonable to assume the demand reduction is almost entirely COVID-19 related and a reasonable proportion (e.g. half) of the payment increase is COVID-19 related (lower prices resulting from lower demand). On that basis it could be estimated that 86% ((2.8+14.1)/(5.6+14.1)) is COVID related – a significant increase on BEIS's 67%. BEIS should set out its working to ensure transparency of the support provided, and that this support will be sufficient to account for the full impacts of COVID-19 on the additional CfD costs.

2. Do you agree with the proposed method for calculating the increase in suppliers' future obligations to enable the LCCC to repay the government loan?

A majority of Energy UK's supplier members have shared concerns that the proposed timing of repayment in Q1 2021 by increasing suppliers' obligation could place unnecessary pressure on suppliers' finances at a time where they are just exiting the winter months, and are therefore in a weaker cash position than at other times in the year.

Given that suppliers could not have predicted the COVID-19 pandemic, in order to recoup the additional CfD costs due to the impacts of COVID-19 suppliers may need to recover additional funds from their consumers. If repayment is due in Q1, then this increase may result in higher costs, than would have otherwise been the case, for end consumers (subject to the Default Tariff Cap, where applicable) over the winter months just as many domestic customers are recovering from the immediate financial impacts of COVID-19. To account for this, it could, be a better customer experience to delay repayment to Q2 to minimise the shock to customers' bills during the anticipated recovery.

Moving the timeline to Q2 2021 would also negate seasonality effects on suppliers' (domestic and non-domestic) market share of eligible demand that are irrespective of customer losses or gains, and minimise any advantage or disadvantage that may occur as a result by comparing the same quarter with the relevant quarter in the previous year.

However, moving the repayment timeline to Q2 2021 does not have unanimous support amongst Energy UK's supplier members. It has been suggested that extending the period before which repayment is triggered will increase the risk of a supplier failing in the meantime, leading to higher costs to all suppliers through mutualisation of that supplier's CfD debt. Specific concerns have also been raised about the ability of non-domestic only suppliers to recover the costs at a later period if their customers continue to cease to operate or struggle financially during the anticipated recession.

We would, therefore, urge BEIS to carefully consider the impacts of its final repayment timelines to ensure that it has fully taken account of the direct consequences and wider implications for both domestic and non-domestic suppliers and customers.

3. Do you agree with the proposal to enable LCCC to take account of anticipated receipt or repayment of a government loan when setting the ILR and when making in-period adjustments?

Energy UK agrees with the proposal in principle to futureproof the regulations in the event of any significant shock that could warrant another intervention. However, in line with comments above, we do not believe that stipulating that repayment must occur in the third quarter following the receipt of a government loan has sufficient rationale. Alternatively, BEIS could consider including some flexibility within the repayment timeline allowing it to increase supplier obligations in the third or fourth quarter following the receipt of a government loan. This would enable BEIS in any future occurrence to ensure that the burden of increased obligations is placed in the most suitable period, taking into account seasonality and suppliers' overall financial positions at certain times of the year.

4. Do you have any other comments on the proposals?

We would welcome clarity from BEIS as to its expectations for the need for similar support to be provided for additional CfD costs in Q3 2020.

Energy UK would also welcome BEIS' considerations for a support mechanism to cover the sharp increases in Balancing Services Use of System (BSUoS) charges. National Grid ESO recently published an updated forecast of BSUoS costs in light of COVID-19 impacts – showing an increase of over £400m between May and August 2020. As with CfD rates, this would be an exceptional price shock for electricity suppliers which could not have been anticipated when setting retail tariffs.

If you would like to discuss the above or any other related matters, please contact me directly on 020 7747 2931 or at steve.kirkwood@energy-uk.org.uk.