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Default Price Cap: Consultation on the process for updating the Default Tariff Cap methodology and setting maximum charges

EDF is the UK's largest producer of low carbon electricity. EDF operates low carbon nuclear power stations and is building the first of a new generation of nuclear plants. EDF also has a large and growing portfolio of renewable generation, including onshore, offshore wind and solar generation, and energy storage. We have around six million electricity and gas customer accounts, including residential and business users. EDF aims to help Britain achieve net zero by 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.

We welcome the opportunity to provide comments on Ofgem's proposals to modify the supply licence to introduce an ability for an amendment to be made to the tariff cap outside of a six-month cycle, where exceptional circumstances occur.

Ofgem duty to have regard to financing activities

Current market events have exposed several shortcomings in the price cap methodology that need to be addressed in order to ensure that that tariff cap continues to protect default customers as required by the legislation that introduced it. A fundamental part of this is to ensure that suppliers who operate efficiently can finance their activities and able to recover their efficient costs under the cap allowance, as required by the Domestic Gas and Electricity (Tariff Cap) Act 2018 (Act). Currently, suppliers are unable to achieve this, and the market as a whole is generally suffering significant financial losses which is neither sustainable nor in the long-term interests of consumers.

We welcome acknowledgement by Ofgem that change is required. However, it is important that a holistic approach to changes to the price cap is undertaken in order to ensure that on a more enduring basis it protects consumers as well as appropriately reflects the costs and risks faced by suppliers. To achieve this will be both challenging and complex. It is essential that single arbitrary changes are not implemented quickly that may detrimentally impact the achievement of these objectives.

We note that Ofgem has recently published a call for input on 'Adaption the Price Cap Methodology for Resilience in Volatile Markets' in which it explores potential alternatives or additional measures that seek to address similar risks to those which this proposal is targeting. In line with the views expressed above, we do not believe Ofgem should proceed with this proposal at this time and recommend that it takes a more considered view of the possible changes that can be made to the price cap to ensure it is more resilient to exceptional market events.

Transparency

We have interpreted the proposals as meaning that there will be a high threshold which would need to be met before Ofgem would consider exercising its ability to amend the tariff cap level mid-period. Although within the consultation document Ofgem refers to circumstances which are rare and would have high impacts without urgent action, the proposed licence condition changes, written as “in the event of exceptional circumstances”, use terminology which is not defined. Given the potential risks and uncertainty for both suppliers and default customers that could arise from any mid-period price cap change we request that Ofgem must, if it continues to progress with its proposal, provide additional clarity on the exceptional events that could trigger the exercise of this new licence condition.

Undertaking any mid-year review will be a complex exercise requiring full consideration of the costs, risks and impacts of any specific cost base change. A single cost change cannot be looked at in isolation; any related impacts also need to be considered including the interactions between the cap and fixed pricing levels, suppliers’ hedging strategies and the levels of switching between SVT and fixed products. Recent events have demonstrated clearly how interconnected these matters are, and we consider that there is very high likelihood that Ofgem would be unable to accurately anticipate knock-on impacts of decisions made on the level of the default tariff cap, were it to make a mid-period amendment. Suppliers would be subject to unmanageable risks if Ofgem passed through cap level changes without a robust and comprehensive review of the full impacts of doing so. Poor decisions could lead to financial losses for suppliers, further damaging resilience in the retail market and in turn causing harm to customers rather than protecting them.

In particular, where Ofgem looked to revise the cap allowance down within a cap period it would need to be able to demonstrate that there was a material decrease in costs for suppliers, including that suppliers are experiencing that decrease within the cap period. An exceptional fall in prompt wholesale costs should not in itself be a trigger for a mid-term cap change as that decrease in costs will not have flowed through to suppliers given their hedged costs would have been set in the earlier observation window. Additionally, suppliers will also be subject to additional costs as a result of a significant fall in wholesale costs as customers move off default tariffs on to cheaper fixed term products and suppliers will therefore be left with a volume exposure to be sold at reduced wholesale prices. These associated impacts would also need to be taken into consideration before any decision could be made, to avoid the risk of harm to customers.

Furthermore, there is no clarity within the consultation about the methodology that Ofgem would use to determine a new cap level, mid-period. This is in contrast to the clear, albeit flawed, mechanism used to set the current 6-monthly price. This presents an unmanageable risk to suppliers that unpredictable and unjustified cap level changes could be made unilaterally by Ofgem, which is not acceptable.

Timeframes

There is a lack of clarity on how in practice Ofgem would undertake the exercise of amending the cap level mid-period, specifically around the timeline of any consultation and the lead time for introducing a revised cap level. Under the current process there is a lead time of around eight weeks between announcement of the cap level and the commencement of the next cap period. This essential lead time is required to allow suppliers to perform their price change processes and regulatory obligations in terms of customer communications. This same lead time period would also be required under any mid-period price cap change process, unless Ofgem provided licence

condition derogations to reduce the time period for implementation (e.g. a relaxation of price increase notification requirements).

There is a further complexity for any mid-period price change that involved an increase in the cap level. In order to mitigate confusion for customers and minimise the risk of incorrect data being used for personal projections, Ofgem would need to avoid announcing an updated revised cap level prior to the original cap period commencing. Given these issues we would like additional information from Ofgem on the expected process for initiating any mid-period price change, were this proposal to be taken forward.

Summary

Given the significant concerns raised above, EDF does not believe that Ofgem has demonstrated a strong case for the implementation of this change at this time. We recommend that a more holistic view of the options available to improve the price cap in the medium term should be undertaken and we are ready to work with Ofgem on its current call for input as part of this process.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Jon Cole or myself. I can confirm that this letter may be published on Ofgem's website.

Yours sincerely

A handwritten signature in black ink that reads "R. Beresford". The signature is written in a cursive, slightly stylized font.

Rebecca Beresford
Head of Customers Policy and Regulation