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Consultation on changes to market stabilisation charge

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 consideration of revisions to the market stabilisation charge (MSC) parameters. While we have been supportive of the principle behind the MSC, we remain concerned that its current design does not appropriately mitigate the risks to suppliers and consumers that arise from unstable and uncertain market conditions. On this basis, we welcome Ofgem's decision to re-assess the MSC parameters to ensure that it meets its policy intent, effectively mitigates the risks of undue financial stress for well managed suppliers in a falling market and allows those suppliers to recover a sufficient proportion of their hedging losses.

Effectiveness of the MSC for Suppliers

We accept that Ofgem's re-assessment is a positive step and to amend both the threshold trigger and derating factor to 10% and 90% respectively would improve the effectiveness of the MSC compared to its original design, and therefore we support the proposed changes. However, we remain concerned with the overall design of the MSC will not in itself allow sufficient cost recovery by suppliers or potentially avoid further supplier exits, as the trigger relates to movements around the wholesale cost allowance set within the price cap and not the actual costs that suppliers are exposed to in a live market.

The actual hedge cost for a supplier will include the volume hedged in line with the price indexation of the cap plus additional costs for purchasing any unexpected SVT volume during a cap period, which Ofgem has already recognised as a significant issue through the wholesale adjustment to the cap allowance. Therefore, the actual costs to suppliers, at this time, are likely to be higher than the value calculated by the MSC.

Furthermore, since the MSC is only triggered by the relative movement of wholesale prices rather than when switching occurs, those suppliers that see a significant reduction in customers will be required to absorb the costs of selling excess volume in a failing market before the MSC is triggered. Depending on the number of customer losses that occur before the MSC is triggered, and the wholesale costs actually incurred by suppliers, this could lead to a supplier failure and makes the MSC obsolete.

Absolute Threshold Levels

The policy intent behind the MSC is to address the risks that would arise in a falling wholesale market and where significant switching between suppliers re-emerges. A key driver behind customer switching is the absolute price differential between the SVT and other alternatives rather than the relative movement of wholesale prices. Therefore, Ofgem should change the threshold so that it is set as an absolute price differential to the price of the SVT.

This approach provides a much clearer indication of when switching is likely to occur and can easily be monitored by suppliers. Furthermore, it would allow a more sufficient proportion of hedging losses to be recovered by a nominal supplier since it would be triggered when actual switching occurs rather than when wholesale prices reduce. As such, this approach would be much more effective in reducing the risk of further supplier failures that creates additional costs to consumers.

Ongoing Review

Ofgem must improve its level of transparency on how it determines what MSC parameters are sufficient to mitigate the risk of further supplier exists. While it is clear that wholesale prices are being considered, it is very unclear what data Ofgem is using to determine the financial resilience of suppliers. Specifically, in terms of timing, it is unclear what evidence Ofgem has used for this review given the proposals were made before the deadline of Ofgem's ongoing stress testing work, which would provide more detailed insight on the financial resilience of suppliers.

Going forward, Ofgem must provide more clarity on how and when it is likely to consider further reviews of the MSC parameters as this can have a direct impact on the hedging strategies of suppliers.

Duration of MSC

The MSC is currently due to expire on 30 September 2022, although we recognise that Ofgem has the power to extend this for a further six months. We urge Ofgem to give stakeholders early indication on whether it deems that the MSC should remain in place until March 2023 given the impact that this may have on supplier's prudent decision making regarding its hedging strategy over the next cap period.

Furthermore, in the event that the MSC will be extended in to the next cap period, there is a clear need for Ofgem to make timely consideration of how any changes to the price cap methodology, including the wholesale allowance, that are currently under consideration will have impact on calculation and the process for updating the MSC.

Technical Amendments

With respect to the technical amendments to the MSC guidance that reflect Ofgem's updated guidance on the treatment of price indexation in future default tariff cap proposals and to account for electricity line losses and unidentified gas, we consider Ofgem's proposals are appropriate.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Steven Eyre 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 'J Cole'.

Jon Cole
Senior Manager, Customers Policy and Regulation