Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

Email: Retailpriceregulation@ofgem.gov.uk

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Price Cap – Consultation on amending the methodology for setting the Contracts for Difference (CfD) allowance

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 possible amendments to the Contracts for Difference (CfD) allowance in the price cap from October 2022 onwards. The effects of continued volatility and high level of wholesale prices has highlighted a number of issues with the current CfD allowance methodology and the extent to which it reflects the costs faced by suppliers and therefore we welcome Ofgem's review.

We accept that the current methodology, which is based on an interim levy rate (ILR) that has a floor of £0/MWh, would not be reflective of supplier costs where the LCCC is forecasting negative payments from suppliers as a result of wholesale prices being materially higher than CfD strike prices for an extended duration. On this basis, we are supportive of Ofgem's proposal that effectively removes the £0/MWh floor within the methodology.

However, we have significant concerns with Ofgem's minded-to proposal, Option 2, that continues with a LCCC forecast that does not contain any reconciliation with outturn costs. Adopting Option 2 will not address the fundamental risks when LCCC forecasts are significantly different to outturn. CfD volume forecasts are becoming more difficult to forecast and we have started to see some generators take a commercial decision to defer entry into the CfD scheme, deciding to sell their output in the wholesale market, at times late in the process when they have greater certainty that wholesale prices will remain higher than their agreed strike price, which has led to a significant increase in CfD costs compared to LCCC's forecast. For instance, we estimate that LCCC's forecast would have increased by around £2/MWh, or £2.50 per account, for the Summer 22 cap allowance as a result of CfD generator delays announced at the end of March 2022.

EDF Energy
90 Whitfield Street
London W1T 4EZ
Tel +44 (0) 00 0000 0000
Fax +44 (0) 00 0000 0000

edfenergy.com
EDF Energy Customers Limited
Registered in England and Wales
Registered No. 2228297
Registered office: 90 Whitfield Street
London W1T 4EZ

Consequently, we strongly urge Ofgem to consider adopting an alternative approach to amending the CfD allowance that better reflects the risks of LCCC forecasts being materially different to outturn rates and the ability of suppliers to recover/payback their CfD costs/benefits under the cap. Wholesale prices are forecast to remain high for an extended period of time and we expect that an increasing number of generators will take this commercial decision to defer entry into the CfD scheme, which will mean that the LCCC systematically under forecasts CfD costs/benefits and therefore suppliers under recovering their efficient costs.

There are a number of approaches in which this forecast risk could be mitigated while at the same time ensuring that the CfD allowance methodology better reflects the costs faced by suppliers in all instances. For example:

- **Ofgem Option 3 Reconciliation to actual rates (our preference)**; using an initial rate of LCCC forecast with an adjustment for previous under/over recovery in most recent available cap period. As the allowance would be based on actual costs this would mitigate any forecasting errors for both suppliers and consumers. This would increase some complexity in terms of introducing a time lag between forecast and reconciliation, however, the concept of a time lag on cost recovery already exists for other costs under the cap; or
- **Using historical rates**; similar to the way in which the cap methodology recovers BSUoS costs, for each cap period set the allowance on the most recent available outturn data. This would be a simple approach to adopt and allow the recovery of actual costs.

Most non-energy cost rates that are unknown until outturn (BSUoS, FiT, and CMSC) are set using historical data. BSUoS uses the last 12 months of actuals, FiT uses last 4 quarters of actuals and CMSC uses average of last and next Winter's costs. CfD is currently the outlier in using only a forward-looking methodology, despite being the most volatile and hardest to predict. Other non-energy costs that are set using a forward-looking approach are a consequence of the rates being known in advance e.g. TNUoS, DUoS and RO.

Finally, in the event that Ofgem proceed with their minded to position and move away from using the ILR it is important that in using a LCCC forecast suppliers have full transparency on the assumptions behind the forecast. This includes a need for the LCCC to publish the eligible demand for the SVT period being calculated, as this is not currently provided on the LCCC dashboard for periods beyond the front two quarters and be clear whether its demand forecast includes EII and GoO adjustments. This additional information would allow suppliers to calculate the £/MWh cost/benefit for forecasting and pricing purposes.

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

J Cole

Jon Cole
Senior Manager, Customers Policy and Regulation