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Dear Dan

Energy Price Cap: Wholesale Costs Review

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.

Suppliers continue to operate in a financially challenging environment and face increasing risks because of continued market volatility and uncertainty and having to operate under the Default Tariff Cap (DTC). EDF remains committed to working constructively with both Ofgem and DESNZ to develop and introduce measures that promote a healthy, well-functioning market that allows efficient and sustainable businesses to attain a fair margin and enable continued innovation and investment to the benefit of consumers.

Ofgem's minded-to position

EDF is supportive of Ofgem's minded-to position of making no adjustment to the price cap for wholesale costs incurred between October 2022 and September 2023. Ofgem's criteria for making ex-post adjustments to allowances under the DTC are if it identifies material and systematic differences between allowances and efficient costs. Based on the evidence gathered by Ofgem through a series of open letters and RFIs, it has identified a wide variety of wholesale costs across suppliers relative to allowances. Some suppliers appear to have experienced costs below the level assumed in the cap, while others experienced higher costs.

This variance in both level and direction demonstrates that divergences in wholesale costs were driven by commercial decisions made by suppliers rather than systematic factors outside suppliers' control driving consistent under or over-recovery during the period. On this basis Ofgem's criteria for an adjustment have not been met and no adjustment should be made. It is vitally important that suppliers' incentives and ability to innovate and drive efficiencies

remain. Ofgem should not seek to claw back commercial benefits achieved by suppliers as part of this or any review as it could blunt suppliers' future commercial and risk management approaches.

Ofgem's review approach

While supportive of Ofgem's minded-to position, we remain concerned with the process Ofgem has adopted in getting to this position. We have previously identified concerns with the lack of transparency, errors in RFIs and the speed and timing of this review. Ofgem should also, in future, avoid preliminary publications that include assumptions that risk damaging market signals and confidence e.g., such as raising the possibility that they might seek to clawback results of commercial decisions. Any future reviews of allowances should start with a clear hypothesis, such that it would be optimal in future to perform relevant and targeted data requests and assessment before publishing public policy documents or statements.

Wider reform

Notwithstanding the above, the evidence gathered by Ofgem through this review does highlight that on average suppliers under recovered by £70 per dual fuel customer across the periods subject to review. Under the DTC suppliers may under or over perform compared to the allowances and this should be appropriately reflected on by Ofgem in any future review of any allowances. Furthermore, this significant under recovery on average by suppliers highlights the significant commercial risks suppliers are exposed to under the current price cap and further demonstrates the need for a broader review/reform of price regulation. EDF wants to work constructively with Ofgem to develop and introduce measures that promote a healthy, well-functioning market. Such a market should allow efficient and sustainable businesses to attain a fair margin and enable continued innovation and investment to the benefit of consumers. The price cap, as Ofgem acknowledge, is an imperfect instrument in this regard and one that drives additional risk for suppliers and costs for consumers. It is critical, therefore, that Ofgem, together with Government, also urgently explore regulatory change that can provide confidence to responsible investors that an appropriate and fair return can be made in this market whilst at the same time the right consumer protections are in place.

Our response to the specific questions set out in the consultation can be found in the appendix to this letter. 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, appearing to read 'John Mason', with a stylized flourish at the end.

John Mason
Senior Manager (Price Regulation and Market Dynamics)

Appendix

Energy Price Cap: Wholesale Costs Review

1. Do you agree with our minded-to position to make no adjustment to the price cap for wholesale costs incurred between October 2022 and September 2023?

As set out in the covering letter, EDF supports Ofgem's minded-to position of making no adjustment to the price cap for wholesale costs incurred between October 2022 and September 2023. This variance in both level and direction by individual suppliers demonstrates that the divergence in wholesale costs was driven by commercial decisions made by suppliers rather than systematic factors outside suppliers' control driving consistent under or over-recovery during the period. On this basis Ofgem's criteria for an ex-post adjustment have not been met and no adjustment should be made.

While accepting Ofgem's minded-to position, Ofgem should recognise that its own evidence demonstrates that on average suppliers under recovered by £70 per dual fuel customer across the cap periods under review. Under the DTC suppliers may under or over perform compared to the allowances and this should be appropriately reflected on by Ofgem in any future review of any allowances.

2. Are the three topic areas identified for medium-term review the right priorities? If not, what alternative topics should be considered?

We agree that the three topic areas for medium-term review of the wholesale allowance as previously set out in Ofgem price cap programme of work, i.e. methodology, quarterly updates and wholesale methodology under market-wide half hourly settlement (MHHS), should be the priority areas.

However, we would reiterate that in addition an urgent review of the Policy Cost Allowance is required due to the discrepancy and variance as a result of the current methodology used for calculating the CfD component. The CfD is a highly volatile cost for suppliers and the forecast from LCCC that is used to set the CfD allowance will inevitably not reflect actual costs. This could result in suppliers being under-compensated or consumers over-paying for CfD costs and can be large in magnitude, with no mechanism for allowances being reconciled to the actual costs charged to suppliers. EDF would welcome discussion between industry and Ofgem on how this could be undertaken, and the evidence required to effect change.

3. What is the relative order of priority between the three broad areas identified for review?

Our preliminary view is that the first two topic areas should be considered initially given Ofgem's anticipated delivery period of Winter 24/25 (as set out in Ofgem Programme of Work Update; April 2023). Consideration of the wholesale methodology under MHHS market-wide should follow as MHHS moves closer to delivery.

4. Within each topic, are there any specific areas of focus you consider should be in scope?

AND

5. Do you have any initial views to share on the topics identified, or more broadly?

EDF has no further views at this time, but we will seek to proactively engage with this work when Ofgem commences its review.

EDF

January 2024