Ed Harris
Energy Economics
Ofgem
9 Millbank
London
SW1P 3GE

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Dear Ed

Quarterly Price Report – Discussion Paper

I am pleased to enclose EDF Energy's response to Ofgem's discussion paper and Quarterly Price Report published on 7 December 2009. This and, I am sure, future such reports are helpful in trying to ensure that customers, customer representatives and commentators all have a better understanding of the drivers behind changes in retail prices.

A key element of this is a proper understanding of the overall financial performance of retail suppliers, which is crucial to assessing how they might respond to changes to their input costs – for example increases or decreases in wholesale market costs. With that in mind, we welcome the move by Ofgem in this latest report to publish data and analysis on net profit margins, as well as gross margins. We do believe however that this analysis could be improved further in certain important respects.

In particular, Ofgem needs to ensure that any analysis of overall supplier margins which it publishes is based upon the most complete and up-to-date cost information. In that context, we welcome the comparative analysis produced by independent energy analysts NERA Economic Consulting (attached as Appendix 2), which has been shared with Ofgem. In NERA's view the Ofgem analysis published in this latest report significantly underestimates the actual costs faced by retail suppliers. It concludes that once all the suppliers' costs have been properly taken into account, supplying retail customers (be they electricity only, gas only or even dual fuel) is currently loss making overall.

In its next Report (or perhaps sooner), Ofgem could usefully respond to NERA's paper, to ensure that this cost issue is clarified and unrealistic expectations about future movements in retail prices are avoided.

Our comments on the specific questions raised in your discussion paper are provided in the attachment (Appendix 1). Please note that some parts of our response are commercially confidential and it would not be appropriate to make these public. These are provided separately.

We hope you find our comments helpful. If you have any queries regarding this response please contact my colleague Ann Neate on 01273 428464, email to ann.neate@edfenergy.com, or myself.

Yours sincerely

Denis Linford
Corporate Policy and Regulation Director

Appendix 1

Chapter 1

1. **Have we (Ofgem) used an appropriate level of aggregation for customer bills i.e. wholesale energy cost, other costs & VAT. If not, what other splits would you suggest?**

We think it would be useful if the explicit costs associated with initiatives to meet government targets for environmental and social issues were separately identified. This would help illustrate the increasing level of social and environmental indirect taxation that is being levied on customers through energy suppliers.

2. **Do you think the 18 month hedging model provides a reasonable indication of suppliers' wholesale energy costs?**

The hedging strategies of individual suppliers are obviously sensitive commercial information. Therefore, we do not know other suppliers' hedging strategies and cannot comment in detail. However, it is important that Ofgem ensure this model is as representative and up-to-date as possible of overall supplier hedging strategies; otherwise incorrect conclusions may be drawn, leading to customers being given false expectations.

3. **Do you have any comments on the assumptions and methodology outlined in appendix 4 of the document?**

A proper understanding of the financial performance of retail suppliers is crucial to assessing how they might respond to changes to their input costs – for example increases or decreases in wholesale market costs. With that in mind, we welcome the move by Ofgem to publish data and analysis on net margins, as well as gross margins. However, our main comment on Ofgem's methodology and assumptions is that Ofgem needs to properly reflect all the costs incurred by suppliers in its analysis of net margins.

As illustrated by the NERA Report, it is far from clear that this is currently the case. For example, Ofgem appears not to have included a number of legitimate costs associated with operating a supply business, such as various social and environmental obligations placed on suppliers, meeting short-term variations in customer demand, bad debt and tariff discounts.

Chapter 2

1. **Is the level of net margin presented in the value chain analysis reflective of actual industry margins?** ***(Page 8 Fig 2.1)***

See confidential response sent separately

2. **Are there any other costs that we should be including?**

See Response to Question 3 in Chapter 1 above

Chapter 3

1. **Do you agree with the data presented in this chapter on choice in the market?**

Whilst we have not checked the precise figures stated in the document, the direction and scale of the movements described are consistent with what we know has happened in the market.

2. **Can you provide any extra information about choices available to consumers?**

The analysis covers most of the available offerings. To provide a comprehensive overview, there are also fixed term products of differing lengths available, tracking products, green energy products, carbon offset products and products for the vulnerable which can be included.

EDF Energy
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