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Email to: RetailPriceRegulation@Ofgem.gov.uk

Date 22 January 2019

Dear Rob,

Capacity Market allowance in the Default Tariff Cap

I am writing in response to your letter of 15 January 2019.

In your letter, you ask whether the default tariff cap should continue to include an allowance for capacity market (CM) costs.

We strongly believe that the recent statement by Government in its consultation paper should be sufficient to make Ofgem confident that supplier capacity market (CM) payments will restart by April, and we therefore think that there is a strong case for continuing to include an allowance within the tariff cap. Clearly, we expect Ofgem to work closely with BEIS on this matter.

Allowing suppliers to recover the CM costs in the price cap is important to give capacity providers confidence that they will get paid for their capacity. Without that confidence, there is a risk that some capacity providers (particularly new build generation, and potentially, demand side response DSR projects) are not progressed. Such an outcome could create risks for security of supply, or at least raise the costs to consumers of ensuring security of supply.

The clear intent of the tariff cap legislation is to allow suppliers to recover costs efficiently incurred under the cap. Subsequent design decisions (about uncertainty mechanisms and headroom allowances) should not, in our view, act as a barrier to Ofgem achieving this goal. Furthermore, we do not think the risk of cost movements arising from a change of law (which is effectively what has happened until the CM scheme is reinstated) is addressed in the headroom allowance. The headroom allowance is used to mitigate uncertainty and volatility (as Ofgem describes in its November 2018 decision document) implicitly within the current paradigm for whatever category of cost being assessed. It would be unreasonable to now assert that such uncertainty and volatility includes a fundamental change to the legal basis of that category of costs (i.e. a wholly new paradigm for that cost category).

We support Ofgem's approach to estimating the expected costs of the T-1 2018 auction.

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To conclude, in accordance with its statutory objective to protect the interests of consumers, Ofgem should take account of not just the technical issues associated with the setting of future price cap allowances, but must also consider the wider impact on generators and other capacity providers should confidence in the Capacity Market be further put at risk. The Government has stated that it is minded to restart supplier payments as soon as possible; it has also been clear that the Court's ruling was based on procedural grounds and did not challenge the fundamental nature of the Capacity Market or find it incompatible with State aid. Moreover, the European Commission has approved similar schemes in other countries. EDF Energy agrees with Government that the Capacity Market is the right mechanism to deliver secure electricity supply at least cost and we believe that Ofgem should have confidence that supplier payments will be restarted and that State aid approval for the scheme will be received in due course.

Should you wish to discuss any of the issues raised in this response or have any queries, please do not hesitate to contact me.

Yours sincerely

A handwritten signature in blue ink that reads "Paul Delamare".

Paul Delamare
Head of Customers Policy and Regulation