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Reassessing the wholesale allowance in the first default tariff cap period

EDF is the UK's largest producer of low carbon electricity. We operate low carbon nuclear power stations and are building the first of a new generation of nuclear plants. We also have a large and growing portfolio of renewable generation, including onshore and offshore wind, as well as coal and gas stations and energy storage. We have around five million electricity and gas customer accounts, including residential and business users. EDF is committed to 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.

EDF welcomes the opportunity to comment on Ofgem's initial thinking regarding its reassessment of the wholesale allowance in the first cap period and potential adjustments. We are supportive of Ofgem conducting a review of suppliers' wholesale costs in the transition cap periods with a view to assessing the extent to which the wholesale allowance provided under the Default Tariff Cap (DTC) was appropriate and reflective of the costs suppliers faced.

We accept that, given the approach adopted in devising the DTC, there are likely to be a number of challenges for Ofgem in how best to carry out its reassessment and subsequent adjustments in future cap periods. We note that Ofgem has identified a number of these within its consultation, to which we offer the following observations.

1. Suppliers in scope

We note that Ofgem in developing the price cap adopted an approach that considered the costs of the six largest suppliers only. This was on the basis that those suppliers' tariffs were the ones that most affect the customers in scope of the cap and also such suppliers were most exposed to the level of the cap given their total proportion of default tariff customers. Adopting such approach led to an assessment that covered nearly 90% of customers on standard tariffs.

We believe Ofgem should adopt a similar approach in respect of its reassessment of cap period 1. Although some consolidation and change in the market has occurred since Ofgem's original analysis, retaining a methodological approach that focusses on the same six suppliers would still result in an assessment that covered over 80% of customers on standard tariffs. We note that to achieve a 90% coverage would involve including Bulb in its assessment. However, as Ofgem highlight within the consultation, although Bulb's variable tariff is technically within scope of the Cap, it is not a default tariff. On this basis excluding it from the assessment would be consistent with the rationale used by Ofgem in excluding other suppliers from developing the Cap.

2. Relevant Cap Periods

We agree that the main impact of the transition to the Cap will be within Cap Period one and that Ofgem's reassessment should focus on this period only.

3. Estimating comparable costs

EDF notes the approach Ofgem proposes to adopt in order to assess supplier costs in a comparable manner to that in which the wholesale allowance under the Cap is set. We have recently received from Ofgem estimates of EDF's comparable wholesale costs for the first period of the Cap which have been calculated using the proposed approach. We are currently assessing these estimates, including the methodology adopted and will provide our detailed views as part of our response to Ofgem's costs estimates which will be submitted by no later than 9 March.

However, we would like to take this opportunity to draw Ofgem's attention to a specific concern we have observed with the approach it has adopted in modelling the comparable wholesale costs of suppliers for Q1 2019. The Ofgem model used to estimate suppliers comparable wholesale costs does not differentiate between Q4-18 and Q1-19 and applies the qualitative hedging strategy we provided in January on a W-18 basis as opposed to looking at Q1-19 in isolation. This simplified approach is not comparable because EDF adopted two structurally different strategies for each quarter due to the cap allowance applying to Q1-19 only. Ofgem should reconsider its approach as it is likely to materially impact the wholesale costs it calculates for the first default tariff cap period.

4. Variation in costs

We accept that given the need to set a single default cap allowance for all suppliers, the allowance will not reflect an individual supplier's costs. On this basis, we are supportive of Ofgem setting the allowance within the highest and lowest supplier costs and adopting an approach that has regard to suppliers' costs on average.

We acknowledge that there are various averages that could be adopted, but at this stage we are supportive of Ofgem's starting position of having regard to a weighted average based on default customer market share. However, we do accept that due consideration should be taken if this weighted average was in some way distorted, for instance, by the costs of an outlying supplier.

5. Setting an adjustment charge

It is acknowledged that setting an adjustment that seeks to reverse the impact, to the greatest degree possible, of the difference between the original cap allowance and that what should have been provided following this reassessment, presents a number of challenges. These include how best to take account of changes in consumption and the composition of default tariff customers from Cap Period one compared to future Cap Periods where any adjustment will be applied.

In this respect, we see merit in Ofgem adopting a relatively simple approach, which while not perfect, would focus on the impact from an individual customer perspective. Such that in principle, we support Ofgem's starting position in adopting an adjustment mechanism that seeks to net out the impact on a per customer basis. However, this is subject to the proportion of customers that fall within the scope of the Cap between Cap Period one and the current position, having not materially changed.

6. Setting an adjustment period

It is possible that there is a trade-off between seeking to recover any under allowance quickly compared to smoothing the impact of any adjustment on consumers. This will largely be determined by size of any potential adjustment to be made in future cap periods. This is as yet uncertain. In terms of this reassessment, we do believe that Ofgem's objective should be to resolve any cost recovery adjustment as soon as possible.

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 this letter is not confidential and may be published.

R. Beresford

Yours sincerely

Rebecca Beresford
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