

04 Feb 2020 | Comment

Fitch Ratings: Consultation on French Nuclear Regulation a Positive Development for EDF

Fitch Ratings-Milan/London-04 February 2020: The recently launched consultation to change the market framework for nuclear power generation in France is a positive development for Electricite de France (EDF; A-/Stable), Fitch Ratings says. The consultation document published by the French government foresees the introduction of a price corridor for the sale of electricity generated by EDF's nuclear plants, confirming the strategic direction already described in the energy planning directive (Programmations pluriannuelles de l'energie) and leading to the end of the Acces regule a l'electricite nucleaire historique (ARENH) system.

As the cap and the floor prices have not been defined, it is not yet possible to derive the impact on EDF's credit ratios. We expect the new system to benefit EDF in terms of amount and visibility of generation margins compared with the current ARENH system. If implemented, we expect it to be a key rating driver for the company and potentially a sign of government support. We estimate that French nuclear generation makes up around 30%-40% of EDF's EBITDA.

In January 2020, the French government published a document for consultation, containing fundamental regulatory changes to be implemented on pricing in the nuclear power generation industry. This formally began a long-awaited regulatory review for EDF's nuclear production. The government presented the idea of a single price for EDF's entire nuclear generation (all existing capacity and Flamanville 3, apart from contracts at negotiated prices not exposed to market) of around 400TWh. This would be set at the wholesale price but within a pre-defined corridor, in order to ensure an adequate price level covering EDF's total nuclear costs (including fair remuneration on capital) and at the same time protect French consumers against any commodity-driven price spikes.

One driver of the reform was to improve EDF's funding capabilities and eliminate some unfavourable characteristics in the current regulation. The envisioned timeline is for the entire scheme to be validated during 2020, including pre-clearing by the European Commission (EC), French parliamentary approval and formal EC validation.

The cap and floor key parameters will be defined by the French regulator Commission de Regulation de l'Energie (CRE). The consultation paper included a proposed spread between cap and floor of EUR6/MWh. We assume that provided that the planned reform goes ahead, EDF's business profile will strengthen, with higher visibility of results and better profitability due to a potential price rise compared with the current ARENH price level. However, we believe this would be defined carefully, and take into account any social impact.

The ARENH was introduced in France in 2011 to protect customers and foster competition. It is currently the reference price (at 42EUR/MWh, unchanged since 2012) for around 70%-75% of EDF's French electricity sales, and does not provide any protection from a market downturn. The system is asymmetric and optional

for alternative suppliers, which can choose whether or not to buy through the ARENH system depending on market conditions (generally they would do so only when the wholesale price is higher than the ARENH price). The remaining 25%-30% of EDF's French electricity sales is currently fully exposed to market trends, mitigated only by hedging transactions.

We expect the nuclear market reform to largely occur in parallel with a group corporate restructuring for EDF, since under the new market structure the nuclear generation should be split by the supply activity. We believe that the company would take the opportunity for a larger restructuring, potentially splitting EDF into 'EDF Blue' (which could include nuclear, hydro) and 'EDF Green' (remaining activities). The restructuring may not have a rating impact by itself. We will analyse its effect once there is greater visibility from an industrial and financial standpoint.

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