

# Default Tariff Cap Statutory Consultation: Energy UK response

8 October 2018

## Introduction

Energy UK is the trade association for the GB energy industry with a membership of over 100 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership covers over 90% of both UK power generation and the energy supply market for UK homes. We represent the diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 27 million homes and every business in Britain. Over 730,000 people in every corner of the country rely on the sector for their jobs, with many of our members providing long-term employment as well as quality apprenticeships and training for those starting their careers. The energy industry invests £12bn annually, delivers £88bn in economic activity through its supply chain and interaction with other sectors, and pays £6bn in tax to HMT.

This is a high-level industry view in response to Ofgem's Statutory Consultation on the Default Tariff Cap; Energy UK's members may hold different views on particular issues raised by the consultation and we anticipate our members to respond individually. Our response is structured to address each individual appendix in turn.

We would be happy to discuss any of the points made in further detail with Ofgem or any other interested party if this is considered to be beneficial.

## Benchmark Methodology

As noted in our response to Ofgem's Policy Consultation, Energy UK does not hold a view towards the most appropriate approach for setting a benchmark for efficient costs, and we expect our members to answer this question in more detail.

Energy UK is concerned about Ofgem's lack of clarity within Appendix 1 as to the rationale and evidential basis it has used to decide upon an efficiency factor equivalent to £5 for a dual fuel customer. Energy UK would, therefore, welcome Ofgem providing sufficient transparency on its rationale and evidence for stakeholders to be able to make an informed assessment of the decision.

## Cap Level Analysis & Headroom

Energy UK anticipates that our members will respond individually on this section.

## **Updating the Cap Methodology**

In line with our response to Ofgem's Policy Consultation, Energy UK retains its broad support for Ofgem's proposal to update the level of the cap in reference to trends in exogenous cost drivers every six months (with the exceptions of the first and last price cap periods), with the included consideration of suppliers' data with regards to the costs associated with the smart meter rollout.

In addition, Energy UK broadly supports Ofgem's decision to review its estimate of smart meter rollout costs in time for the price cap period starting 1 October 2019. We expand on this aspect below when considering Ofgem's position on smart meter costs.

## **Wholesale Costs**

Energy UK is concerned with the lack of evidence put forward by Ofgem to rationalise its change to the observation period to be referenced when setting the wholesale cost allowance for the first price cap period. The new observation period had not been consulted on in the Policy Consultation in May and Ofgem has not produced evidence for the change to be intelligently assessed by stakeholders. Overall, as mirrored in the section on smart costs below, Energy UK believes that Ofgem has failed to provide suppliers' advisors with sufficient visibility of data in its Disclosure Room regarding its treatment of wholesale costs. As such, suppliers' responses to the Statutory Consultation will be unable to highlight and assess the impact of any methodological shortcomings, such as on price-volume correlation, shape costs and the daily imbalance calculation.

Energy UK would welcome clarity as to how Ofgem will consider the impacts of future policy decision on suppliers' wholesale costs. Of particular note are potential changes to the Market Making Obligation (MMO) which would take place during the life of the price cap. Such policy developments have not been accounted for in the price cap and suppliers seek reassurance that allowances will adequately reflect any impact upon costs.

Of particular concern to Energy UK is Ofgem's proposed treatment of Unidentified Gas (UIG) costs. First and foremost, Energy UK does not believe that the allowance for UIG should be fixed as part of the cap. Contrary to Ofgem's rationale is not a simple question of getting daily reads. There are a multitude of drivers, with many of them being legitimately outside the control of an individual supplier.

Due to the volatility in costs outside of an individual supplier's control, Energy UK believes the UIG allowance should be a variable that can be adjusted at each price cap level review, based upon the latest Xoserve data and modelling. Just as with network costs, Ofgem should allow suppliers a cost reflective allowance based on the data available.

## **Policy & Network Costs**

Energy UK is concerned that Ofgem has not set out how they expect to take account of new policy costs throughout the lifetime of the cap. For example, Ofgem has yet to assess the impact of its proposals for automatic switching compensation, implementing Midata sector-wide, systems costs for market-wide settlement reform and realising faster switching. Of particular concern is that, as currently proposed, individual suppliers will face costs driven by regulation and legislation and due to the nature of the costs there is inherently no way to appropriately forecast potential future costs. As such, when assessing the impacts of its policy proposals throughout the lifetime of the cap, Ofgem must also assess the impacts of the policy proposals on the level of the cap and suppliers' ability to recover legitimate costs.

## **Operating Costs**

Energy UK anticipates that our members will respond individually on this section.

## **Smart Metering Costs**

Energy UK continues to support Ofgem's proposal to separately index the costs incurred as a result of the smart meter rollout. Ofgem's understanding and treatment under the cap of costs associated with the smart meter rollout is a key concern of Energy UK's members, which has been communicated previously.

To ensure the robustness of Ofgem's ultimate decision on the level of the cap and the treatment of certain cost elements, all stakeholders must have the ability to adequately scrutinise the data and assumptions used by Ofgem in the cap's design. Energy UK believes that Ofgem has failed to provide a sufficient level of transparency of its assumptions and underlying data through the Disclosure Room to enable stakeholders to intelligently interrogate Ofgem's proposals.

Energy UK supports Ofgem's proposal to review its estimates of smart meter rollout costs ahead of the price cap period beginning on 1 October 2019. This should be a full review of all elements making up the SMNCC and not be restricted to certain parts. In order to ensure that smart costs are appropriately accounted for Ofgem should reopen its Disclosure Room as part of the review. However, the Disclosure Room opened by Ofgem as part of the Statutory Consultation has not afforded stakeholders with sufficient data or access to effectively scrutinise the treatment of smart costs under the cap. Firstly, by excluding from the Disclosure Room the complete data set used in its design of the default tariff, Ofgem failed to provide stakeholders with sufficient levels of data to permit stakeholders to give intelligent considerations to the methodology and to provide adequate response to the statutory consultation overall. Secondly, restrictive access to the Disclosure room had meant that stakeholders lacked adequate time for their considerations and response.

Energy UK, therefore, believes that in such a future iteration of the Disclosure Room a number of improvements should be made to both the level of access granted and scope of data included in order to help fully realise the benefits of the exercise.

## **Payment Method Uplift**

As noted in Energy UK's policy consultation response, we welcome Ofgem's acknowledgement that suppliers face legitimate, differing costs based on the payment method of their customers. Energy UK believes that a general principle of cost-reflectivity should apply to the tariff cap. However, we expect Energy UK members to respond individually to the proposal to implement different caps based on payment methods and the level at which certain costs should be socialised.

However, Energy UK has concerns regarding the operational impact the implementation of the cap will have on suppliers' systems, and the knock-on effect on customers. For example, a change from a direct debit discount reflected solely in the standing charge, to a discount with both fixed and variable elements, adds complexity and potential confusion when communicating this to customers and makes tariff comparisons harder.

In addition, as currently proposed, PPM customers with traditional meters will be on one cap, and PPM customers on default/variable tariffs with SMETS2 meters on another cap. This could have negative impacts for the smart rollout, customer experience and engagement. When switching, there may be confusion as to which tariff customers are being quoted for, whether or not they have a SMETS2 meter, and complications for suppliers' systems. With regards to the customer's experience and engagement, if the customer has to change to a different tariff if they accept a smart meter, they may be put off from switching or accepting a smart meter altogether. Energy UK would urge Ofgem to consider these impacts on suppliers' systems and customers' experience, which it has not to date.

## **EBIT**

Energy UK anticipates that our members will respond individually on this section.

## **Exemptions to the Cap**

Energy UK welcomes the clarity provided over Ofgem's proposed approach to allowing suppliers to apply for a derogation for tariffs that support renewable energy. In particular, we welcome the two-stage transitional derogation process proposed by Ofgem as a means to address the concerns raised over the impact on customers and renewable offerings of potentially delayed approvals in Energy UK's policy consultation response. Energy UK also welcomes Ofgem's proposal to also allow derogation applications to be made in relation to gas tariffs, as we had previously requested.

We note that Ofgem intends to develop the detailed criteria used to assess derogations over the coming weeks and months. While it would have been more effective to have had detailed the necessary criteria as part of the consultation itself, Energy UK would urge Ofgem to provide the final details of the exact criteria and guidance for suppliers at the earliest opportunity after properly considering responses to its outlined current expectations.

**If you would like to discuss the above or any other related matters, please contact me directly on 020 7747 2931 or at [steve.kirkwood@energy-uk.org.uk](mailto:steve.kirkwood@energy-uk.org.uk).**