

Lind Invest's inputs to the Price Cap consultations

Lind Invest is based in the Nordics – where the energy markets liberalized early and where prices are driven by competition rather than regulation, with great success. Lind Invest has from 2004 to 2019 been the majority owner of Danske Commodities; a company with significant presence in the UK wholesale markets within both electricity and gas.

Wholesale volatility

We are in favor of a market with free price setting, in which, healthy competition will ensure consumers are charged a fair price, development of new products and solutions and a fair risk adjusted return to the suppliers. Therefore, we do not consider the price cap to be neither a near- or long-term solution for the sector.

Near-term changes to the price cap:

Based on the published energy companies' Consolidated Segmental Statements only one of the 5-6 largest players has been able to be profitable under the current price cap methodology in the past 2 years. And with the recent wave of defaults, it is in our view an unhealthy sector where one would expect the companies' willingness to invest in new and innovative solutions to the benefit of consumers and the market will be present. The short-term benefit from too low prices will come at the cost of future underdeveloped product solutions that might be less energy efficient and less innovative than in a highly competitive market.

We consider the price cap to be a non-optimal mechanism to ensure a fair and competitive price to consumers and a healthy environment for the development of new solutions at the same time. However, as the near-term flexibility to make amendments to the current regulation is limited, we propose the following under the current price cap methodology:

1. Amend the EBIT/cost calculation to ensure a healthy industry where the suppliers on average earn a positive and fair EBIT-margin for them to have the financial strength to withstand the volatility of wholesale prices, to innovate new solutions and generate a fair risk adjusted return to suppliers. The four major suppliers that publish their Consolidated Segmental Statements have delivered an EBIT-margin between -6% to 2% on retail consumers the past two years with 3 out of four having an EBIT-margin of -2% or less. Therefore, we consider a 4-percentage point increase to the EBIT/cost calculation is needed for the industry to deliver a fair risk adjusted return to the suppliers.
2. Amend the frequency of the price cap updates to ensure that the price better reflect the current environment, effectively decreasing both volume and price risk for suppliers to benefit the stability of the sector. We suggest that the price cap will be announced weekly based on the prevailing forward curve with the option for consumers to choose between durations of 3- or 12-months.
 - a. An increase in frequency will also decrease the cost of unexpected switch to SVT, which is yet another unfair risk to the suppliers during extreme events.

Long-term changes to the price cap:

Our suggestion for a long-term solution is to let the market participants set the energy price based on competition with some targeted efforts to ensure transparency of products, reduced excessive risk taking and to protect vulnerable consumers. Our suggestion consists of these four topics:

1. Free price setting by market participants
2. Limit the product offering for suppliers to maintain transparency for consumers
3. Implement a financial risk management framework to limit risk of default
4. Price rebates for vulnerable consumers

We believe that the volatility in the prices needs to be reflected continuously in the prices offered to the consumers to create stability of the industry while being competitive. The current price cap will save consumers money during this winter, but it will come at the cost of future payments during the summer, recovering of the cost associated with the large number of defaults and an underdeveloped product offering.

We suggest that Ofgem limit the energy suppliers to offer energy contracts with up to 3 maturities (half hourly, 3 months and 12 months) to keep the product offering simple and easily manageable by the consumer. To limit the volume risk for suppliers the consumers should not be able to make changes within the contract period, e.g., with half hourly fixings the consumer is able to switch to another contract duration or supplier whenever they want to.

We will suggest that Ofgem implement a stress test on energy suppliers to increase the financial risk management used by energy suppliers. The purpose of the stress test is to determine whether the energy supplier has an appropriate hedging strategy, cash balance or committed credit facilities to withstand a shock to the energy price like the one we have faced recently. The energy supplier can choose a combination of the risk mitigation tools to be able to continue operation in a volatile environment. Appropriate financial risk management and certain financial requirements linked to risk involved will decrease excessive risk taken by energy suppliers at the cost of consumers and the remaining energy suppliers and, thereby, create more stability to the sector.

With respect to the vulnerable consumers, we consider a targeted approach to much more efficient than one-size fits all. Therefore, we suggest that a public body to be set up where weak consumers, based on a predefined criterion, can seek a part refund of the energy price paid based on the consumers' individual financial situation.

Updating the Default Tariff Cap

We do not support the ability to amend the price cap outside the routine six-month cycle of 3 main reasons, 1) it will create additional uncertainty for both customers and suppliers, 2) it will be another free option for speculative suppliers as they might be supported if they are underhedged in the same way as we see the current crisis, and 3) it will not solve the current unintended limitations of the price cap. We will instead refer to our suggested amendments for near-term changes to the price cap.

We are prepared to engage further with you to clarify our views, and we are also ready to provide additional comments when you have announced a wider range review of the price cap.

Please do not hesitate to contact us.

Best regards,

Michael Hugener Nielsen, Lind Invest